H.R. 1375—THE FINANCIAL SERVICES REGULATORY RELIEF ACT OF 2003

HEARING

BEFORE THE

SUBCOMMITTEE ON
FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

OF THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

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JOSEPH CROWLEY, New York
STEVE ISRAEL, New York
MIKE ROSS, Arkansas
CAROLYN McCARTHY, New York
ARTUR DAVIS, Alabama

CONTENTS

WITNESSES

THURSDAY, MARCH 27, 2003

APPENDIX

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

H.R. 1375—THE FINANCIAL SERVICES REGULATORY RELIEF ACT OF 2003

Thursday, March 27, 2003

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS
AND CONSUMER CREDIT,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to call, at 10:10 a.m., in Room 2128, Rayburn House Office Building, Hon. Spencer Bachus [chairman of the subcommittee] presiding.

Present: Representatives Bachus, Bereuter, Baker, Royce, Gillmor, Biggert, Capito, Tiberi, Hensarling, Brown-Waite, Barrett, Oxley (ex-officio), Sanders, Maloney, Watt, Sherman, Moore, Waters, Hooley, Lucas of Kentucky, and Ross.

Chairman BACHUS. [Presiding.] Good morning. This is the Subcommittee on Financial Institutions and Consumer Credit. The subcommittee meets today for a legislative hearing on H.R. 1375, the Financial Services Regulatory Relief Act of 2003. That legislation was introduced by our colleagues on the subcommittee, Ms. Capito, of West Virginia and Mr. Ross of Arkansas. It is similar to the regulatory relief package, H.R. 3951, that was approved last year by the subcommittee and by the full committee after two hearings before our subcommittee. That legislation was largely a product of recommendations that the committee received from federal and state financial regulators in response to a request for regulatory relief recommendations from Chairman Mike Oxley.

Earlier this year the Chairman again requested that the financial regulators recommend regulatory relief proposals. And, H.R. 1375 is essentially last year's legislation with the addition of various, what we think are uncontroversial provisions recommended by regulators. The banking industry estimates that it spends somewhere in the neighborhood of $25 billion annually to comply with regulatory requirements imposed at both the federal and state level. A large portion of that regulatory burden is justified by the need to ensure safety and soundness of our banking institutions to enforce compliance with various consumer protection statutes and combat money laundering and other financial crimes.

However, not all regulatory mandates that emanate from Washington or State capitols across the country are created equal. Some are overly burdensome, unnecessarily costly or duplicate other legal requirements. Where examples of such regulatory overkill can be identified, Congress should act to eliminate them. The bill that Congresswoman Capito and Congressman Ross have introduced,

and which, I, Chairman Oxley and several other members of this body are co-sponsors, contains a broad range of constructive provisions that, taken as a whole, will allow banks and other depository institutions to devote more resources to the business of lending to consumers and less to the bureaucratic maze of compliance of outdated and unnecessary regulations.

Reducing the regulatory burden on financial institutions lowers the cost of credit and will help our economy as it strives to emerge from recession.

In closing, let me once again commend Ms. Capito and Mr. Ross for this important legislative initiative, as well as the full committee chairman, Mr. Oxley, who is an original co-sponsor of the legislation. I also commend the ranking member, Mr. Sanders, for the cooperation that his staff and the democratic staff has put forth in composing this bill.

Chairman Oxley's demonstrated a strong commitment to getting regulatory relief legislation enacted this year. The Leadership has endorsed his efforts. And, finally, I want to thank the federal banking agencies represented on our first panel for their important input and technical assistance in the drafting in process.

With that, I am pleased to recognize, the ranking member, Mr. Sanders, for an opening statement.

Mr. SANDERS. Thank you, Mr. Chairman. And thank you for holding this hearing. Let me begin by apologizing and saying I am going to be running back and forth between this hearing and another hearing on a committee that I am in. So, I will be drifting back and forth.

Among other things, the Financial Services Regulatory Relief Act would make it easier for some of the largest banks and other financial institutions in this country to merge. Specifically, the bill would reduce the federal review process for bank mergers from 30 days to a mere five days. The bill would allow the Office of the Comptroller of the Currency to waive notice requirements for national bank mergers located within the same State. The bill would end the prohibition of out of state banks merging with in-state banks that have been in existence for less than five years.

The bill also gives federal thrifts the ability to merge with one or more of their non-thrift affiliates. Finally, the bill would eliminate certain reporting requirements for bank CEO's in regards to inside lending activities.

Mr. Chairman, I have serious concerns regarding these provisions in the bill. During the past 22 years the banking industry has experienced unprecedented merger activity. From 1980 to 2002 there were over 9,500 banking mergers with total acquired assets of more than $2.4 trillion. During the 1990s many of these mergers involved large banks. Some of the proposed mergers had the potential for serious anti-competitive effects in local markets.

Yet, during this period, hardly any mergers were denied based on competitive grounds. Huge anti-competitive situations, but none of these mergers, very few of them were denied. As a result of merger mania there has been a substantial decline in the number of commercial banking organizations in the United States. We have gone from 12,741 commercial banks in 1989 to 7,903 in 2002. In 1998 several of the largest bank mergers in history took place. For

example Nations Bank merged with Bank of America resulting in the third largest banking organization with approximately 580 billion in assets.

In addition, Norwest merged with Wells Fargo and Bank One merged with First Chicago. Finally, Travelers Group and Citicorp has merged and formed the largest banking organization in the United States. The 25 largest banks in this country now account for more than half of all of the total deposits in the United States. It is my understanding that the Federal Reserve Board and the Office of the Comptroller of the Currency have published descriptive material on fewer and fewer of these merger decisions. And I think that that is, in itself a serious problem.

I am very concerned that as a result of these mergers an increasing number of banks are considered too big to sale, too big to sale. In other words, these banks are now so big that if they should get into trouble it will be the American taxpayer who will have to bail them out because the argument will be made that the consequences of those failures are so great for our economy that the taxpayers of this country must bail them out.

I would like to hear discussion today from some of our witnesses as to how many banks they consider too big to fail. What are the dangers for the taxpayers of this country in terms of reliving the S&L crisis, which cost us so many billions of dollars?

Mr. Chairman, has merger mania led to reduction in bank fees for the American consumers? We are talking about fewer and fewer and larger and larger banks that obviously the assumption is the average person benefits. I guess fees must have been reduced. Low-income people, working people, must be better off. Unfortunately, the evidence seems to indicate that mergers have not worked for the benefit of ordinary people. In fact, the American consumers today are facing a real crisis in banking services. More than 12 million American families cannot afford bank accounts and those who can afford them are paying too much, especially if they bank at big banks.

Since bank deregulation began in the early 1980s consumer groups, such as U.S. PIRG have documented skyrocketing consumer banking fees. Bank fees are rising dramatically. Big banks are getting bigger and bank fees are going up. And I think the American people want a hard look at that. The average annual cost to a consumer of maintaining a regular checking account rose to more than $200 over the past few years, an increase of $17 compared to 1997. Consumers who bank at big banks paid more than $220 a year for the privilege of maintaining a regular checking account, that is a lot of money for a regular checking account.

Furthermore, what needs to be looked at what are the implications of these mergers for workers, the people who work at banks? Are we creating more jobs or are we creating fewer jobs? What happens when the workers in one bank have a defined benefit pension plan and they merger with another bank that has a cash balance pension plan and when these two banks merge, do the workers who had the better pension lose out? There is evidence that that may be the case.

So, Mr. Chairman, I want to thank you for holding this important hearing. And I will be skipping in and out and apologize for

that. But, there are some important questions that I think need to be answered by our witnesses and I thank you, again, for holding this hearing.

Chairman BACHUS. Thank you, Mr. Sanders for pointing out those issues.

I want to first apologize to our State banking regulators and credit union regulators. Mr. Gee and Ms. Lattimore are here representing State regulators. So, when I commended our Federal regulators for being here, I did not mean to leave the two of you out, but obviously I did and I apologize for that. Our state regulatory bodies are very important to us. So, please accept my apologies.

At this time I am going to recognize the chairman of the full committee for remarks. And, then, the ranking member, Mr. Frank, is not here, if he arrives. And then the two sponsors of the legislation for their opening remarks.

So, at this time I am going to go to Chairman Oxley.

Mr. OXLEY. Thank you, Mr. Chairman. And I appreciate you holding the hearing today on this important subject of regulatory relief. Two years ago I asked the financial regulators to recommend current statutes that could be altered or eliminated to lighten the regulatory burden on insured depository institutions, as well as much needed technical corrections. Part of our role in this committee is to periodically review and, if necessary, change banking statutes that have outlived their usefulness. It was also my intention to counter-balance the added regulatory responsibility given to the financial services industry in the Patriot Act, which had gone through our committee in the last Congress.

In response, the regulators, as well as the industry, submitted a number of wide-ranging proposals affecting banks, savings associations and credit unions resulting in H.R. 3951, which was introduced last year by Representative Capito and approved by this subcommittee and the full committee. I am pleased that Ms. Capito recently introduced H.R. 1375, the Financial Services Regulatory Relief Act of 2003. H.R. 1375 is essentially last year's bill with a few revisions and about a dozen new items requested by regulators to achieve the balancing act necessary for this bill. Not only does Representative Capito deserve a great deal of credit, but so do the regulators who have come to the table to identify the provisions included in this bill and are testifying today.

And, let me say that we are particularly appreciative of the regulatory agencies' suggestions. It is pretty easy to go to the regulated community and ask for horror stories and ask them about regulations that they feel are unfair or burdensome. It is quite another for the regulators to step up and identify those regulations and, indeed, some statutes that have outlived their usefulness as a result of changes in technology and changes in the market place. The financial services industry spends a lot of money complying with outdated and ineffective regulations. That is money that could instead be lent to consumers and businesses for new homes, cars and projects that fuel growth in the local community.

Financial institutions play an important role in preventing money laundering and protecting against terrorist financing. They should not be burdened by unnecessary regulatory requirements.

So, I look forward, Mr. Chairman, to working with you and Ms. Capito and Representative Ross, who have joined me as original co-sponsors as we begin hearings on this important legislation. I am pleased to yield back.

Chairman BACHUS. Thank you.

At this time Ms. Capito?

Mrs. CAPITO. Thank you, Mr. Chairman. I appreciate you holding this hearing today and I want to thank our distinguished witnesses for appearing before this subcommittee. I want to thank Chairman Oxley and my colleague from Arkansas, Mike Ross, for working with me on this legislation.

As was the case last year, the intent of this bill is to eliminate outdated laws, update those requirements that have not kept pace with technology and streamline several reporting requirements to eliminate unnecessary redundancies. This type of regulatory review is especially important, given the significant changes that the Gramm-Leach-Bliley Act and the Patriot Act brought to the financial services industry.

H.R. 1735 is essentially the same legislation the committee considered last year, incorporating most of the changes made during the subcommittee and full committee markup. Regrettably, we were unable to consider this on the floor in the 107th Congress, but since that time we have received additional feedback from the various regulators, and, as a result, have added several new sections to the bill, many of which I hope will be discussed during this hearing.

Many of the provisions in this legislation are very technical in nature. And I will encourage my colleagues to take full advantage of the experts before us this morning.

Mr. Chairman, while federal regulation plays an important role in protecting consumers, instilling confidence and ensuring a level playing field, over regulation can depress innovation, stifle competition and actually inhibit our economy's ability to grow.

I look forward to working with my colleagues and the chairman in reviewing the changes outlined in this legislation with the goal of creating common sense regulatory relief bill that will help the financial services community thrive, compete and offer the best services for its consumers.

I thank the Chair.

Chairman BACHUS. Thank you.

At this time I am going to recognize Mr. Ross for an opening statement. And are there other members on our side that wish to make an opening statement? So, if not, we will have Mr. Ross's opening statement and then we will hear from the panel.

Mr. ROSS. Well, good morning, Chairman Bachus and Ranking Members Sanders and members of the committee and I think by the time it gets to me just about everything that can be said has probably been said. But, I want to thank you, Mr. Chairman for this hearing today on H.R. 1375 to discuss ways that Congress can provide the regulators with the assistance needed to streamline the operations and hopefully improve productivity.

I can say a lot of things about this bill that I am proud to co-sponsor, but the bottom line is its common sense legislation that is badly needed. And I look forward to the testimony of the wit-

nesses and working with my colleagues on this important piece of legislation.

Thank you, Mr. Chairman.

Chairman BACHUS. Thank you.

At this time, if no other members have an opening statement, let me introduce the panel. And I am going to go from my left to right. We have the Honorable Mark Olson, who is a member of the Board of Governors of the Federal Reserve System here in Washington. Welcome. We have the Honorable Dennis Dollar, Chairman, National Credit Union Administration. We have Ms. Julie L. Williams who is the First Senior Deputy, Comptroller and Chief Counsel for the Office of Comptroller of the Currency. We have Mr. William Kroener, General Counsel of the Federal Deposit Insurance Corporation. And, I drop the third from my name sometimes, so I am doing this to you this morning.

Ms. Carolyn Buck, Chief Counsel, Office of Thrift Supervision; Mr. Gavin Gee, Director of Finance, Idaho Department of Finance, on behalf of the Conference of State Banking Supervisors; and Ms. Jerrie J. Lattimore, who is the Administrator of the Credit Union Division, State of North Carolina, on behalf of the National Association of State Credit Union Supervisors.

So, we welcome all of you all. We will start our opening statements. You have probably been told to limit it to the five minutes. But, we do allow people to run over a minute or two. And we will do that this morning. But, it is not encouraging you to go more than five minutes, but you do have that opportunity.

Governor Olson, we will start with you.

STATEMENT OF MARK OLSON, MEMBER, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Mr. OLSON. Thank you very much, Mr. Chairman, and thank you for holding this hearing. And, thanks also, to the chairman of the full committee for his asking us, as you pointed out in your opening remarks, to submit suggestions to you for inclusion in this legislation.

We have submitted a statement for the record. I would just like to highlight a few of the items that we have included and then we will be able to respond to questions in greater detail if there are any from the members. One of the suggestions that we have included concerns interstate branching. In the Riegle-Neal legislation interstate branching was allowed for the first time, but it was allowed on an opt-in basis by the State.

17 States have adopted the opt-in and 33 have not. And, as a result of that, it particularly impacts, we believe, the smaller banks whose natural markets are along State borders. Whereas, a large bank organization could branch into a state through an acquisition, a smaller bank would find that to be expensive and cumbersome. And we think that this will encourage branches in those markets, many of which are now somewhat underserved.

We would also point out, however, that if the committee chooses to include this recommendation, that it would not include the ILC's, the industrial loan companies that operate outside of the construct of the Gramm-Leach-Bliley provisions that were so carefully put together by the Congress in 1999.

A second issue that is important is allowing insured banks to engage in interstate mergers with thrifts. Right now banks are allowed to merge interstate with other banks, but not with thrifts or with uninsured trust companies. So, those acquisitions now do take place, but they only take place after the thrift goes through a conversion to a bank charter. And it is an unnecessary, expensive and time-consuming step.

The third provision that we have interest in involves the merchant banking provisions under the Gramm-Leach-Bliley Act. There are certain cross marketing opportunities that are allowed in a very narrow sense for merchant banking, companies that are held in the merchant banking portfolio by insurance entities that are part of the financial holding company, but are not allowed at the moment for banks that have ownership of a corporation in its merchant banking portfolio. These are very limited cross marketing opportunities, and we are suggesting that the banks ought to have the same opportunities as the thrifts.

Also, we do not believe that the cross marketing provision should be included where the banks portion consists of less than a controlling ownership in the merchant banking investment.

A fourth provision that is of interest concerns the attribution rule for stock that is owned under trust provisions. In certain instances, where a company's stock is owned under certain trust provisions for the benefit of the employees or stockholders or members, those shares are included in the attribution rule for purposes of determining whether or not there is control.

We have found that there are a certain limited number of cases, mostly involving the 401k's or IRA's where there are self-directed investments; where the attribution rule in net appropriation. We are asking for the opportunity to waive the right, not to repeal the statute, but to waive the right in certain instances where that is determined to be the case.

A final one that I would like to mention this morning is the post-approval waiting period. That is now a 30-day period by statute. It can be reduced to 15 days. We are suggesting that it could be reduced again to a five-day waiting period. Importantly, that would only be done after the U.S. Attorney had reviewed the case and determined that there were no anti-competitive issues involved.

We have some other provisions, Mr. Chairman, that I would be happy to respond to questions, but I think those are the ones that I would like to mention in my opening statement.

[The prepared statement of Hon. Mark Olson can be found on page 124 in the appendix.]

Chairman BACHUS. Thank you.

Chairman Dollar?

STATEMENT OF HON. DENNIS DOLLAR, CHAIRMAN, NATIONAL CREDIT UNION ADMINISTRATION

Mr. DOLLAR. Well, thank you, Mr. Chairman. We appreciate so much the opportunity to be here today on behalf of the National Credit Union Administration. I think it would be very difficult with our names for Ms. Buck and I not to be here to discuss common sense legislation.

Chairman Oxley, we appreciate his leadership and Representative Capito and Representative Ross for theirs as well on this particular piece of legislation.

We continue to believe that this legislation will positively impact our ability to provide a safe and sound regulatory environment for America's credit unions in what is, indeed, an ever-changing and dynamic financial marketplace. And I would like to just briefly discuss the following recommendations that are included in H.R. 1375 that address regulatory relief and productivity improvement for federal credit unions.

These proposals, as presented in the bill, are consistent with the mission of credit unions and the principles of safety and soundness. First is regarding check cashing, wire transfer and other money transfer services. In order to reach the unbanked, Mr. Chairman, Federal credit unions should be authorized, we believe, to provide these services to anyone eligible to become a member. This is particularly important to the overwhelming majority of federal credit unions whose field of a membership include individuals of limited income or means. These individuals, in many instances, do not have mainstream financial services available to them and are often forced to pay excessive fees for check cashing, wire services, wire transfers and the like. We are pleased to see that Section 307 of the bill does include this provision and we certainly support that.

The one-size-fits all 12-year maturity limit on federal credit union loans is also outdated and unnecessarily restricts federal credit unions' lending authority. NCUA is pleased that our recommendation regarding this has also been incorporated in the bill in Section 304, and we support this.

The 1 percent aggregate investment limit for a credit union in a CUSO or a credit union service organization, is a statutory provision that is unrealistically low and forces many credit unions to either bring services in-house, thus, potentially increasing risk of the credit union and the insurance fund or to turn to outside providers and run the risk of losing control.

NCUA is very comfortable with the solution that has been proposed by the legislation in Section 305, which increases that CUSO investment limitation from 1 percent to 3 percent.

The Federal Credit Union Act also, we feel should be amended and this legislation does do so to provide some additional conservative investment authorities that have been proven sound and safe by State chartered credit union and some other financial institutions. With proper restrictions as drafted in the legislation, as has been provided in Section 303, we can support the provisions that you have given to expand credit union investment options in a safe, sound and conservative manner.

The Federal Credit Union Membership Act also allows voluntary mergers of healthy federal credit unions. There is no logical reason, however, to require in connection with those mergers, that groups of over 3,000, or any group for that matter, be required to spin-off and form a separate credit union. These groups are already included in a credit union in accordance with statutory standards and that status is unaffected by a merger. NCUA is pleased to see that Section 308 of the proposed legislation as drafted addresses these concerns.

Another item that we are pleased to see included in this year's bill, Section 313, is the provision to provide regulatory relief from the requirement that credit unions register with the Securities and Exchange Commission as broker dealers when engaging in certain specified de minimus securities activities. The requested parity relief is consistent with that granted to thrifts in this legislation and it would apply only to those activities otherwise authorized for credit unions under applicable credit union chartering statutes. It does not in any way increase the authorities of credit union for such things, but it does allow them to continue to do such things as third party brokerage arrangements, sweep accounts and certain safekeeping and custodial activities without requiring the cost and the burden of registration.

We have also reviewed the other provisions that have been added to the bill that were above and beyond the items that were submitted by us as a regulator last year. All of those provisions we have reviewed from a safety and soundness perspective and have no safety and soundness concerns whatsoever with those additions.

One last item I would like to address before I close, Mr. Chairman, is regarding the issue of privately insured credit unions and the Federal Home Loan Bank membership. Last year, NCUA took no formal position on that section of the bill. And, again, we take no official position on the public policy issue involved in that section this year. However, we do find ourselves uncomfortable with changes to Section 301 as it appears in that section of the bill this year for the following reasons:

Our concern stems from the language which has been added to the original section, which makes it appear that oversight responsibility for non-federally insured credit unions and certain State regulated private share insurance companies rest with NCUA. NCUA, Mr. Chairman, has no legal authority, regulatory or supervisory jurisdiction over these non-federally insured credit unions or commercial insurance companies, nor do we seek it. In our view the language requiring private insurance providers to submit copies of their annual audit reports to NCUA should be considered for being removed to avoid any potential consumer confusion and misunderstanding. In its passage of the FDICCIA Act in 1991, Congress designated the Federal Trade Commission as the agency responsible for oversight of private deposit insurance companies and the protection of consumers through appropriate disclosure provisions. As the matter remains one of consumer awareness, disclosure and notification, and not of federal credit union regulation, NCUA feels strongly that the Federal Trade Commission should retain this oversight authority. The additional language, which could be interpreted to infer an NCUA role that is neither appropriate, nor statutorily authorized to provide oversight to either State chartered privately insured credit unions or a private insurance company regulated by an agency designated by State statute should, in our opinion, be removed from Section 301.

It has been five years, Mr. Chairman, since Congress has thoroughly addressed our statutes and the regulations that emanate from them. The review and relief sought in this proposed legislation is, indeed, both needed and timely. Our goal at NCUA as we implement these regulatory relief provisions and any others that

Congress ultimately chooses to enact, will be to take all actions with an eye towards removing unnecessary regulatory burdens while maintaining, as is proven by the historical strong performance of America's credit unions, our first and foremost priority and commitment to both safety and soundness and necessary regulation to protect the American public. On behalf of the NCUA board, I am glad to be here today to work with the committee, to work with the subcommittee as we draft this important, and, I agree, again, common sense legislation.

Thank you, Mr. Chairman.

[The prepared statement of Hon. Dennis Dollar can be found on page 62 in the appendix.]

Chairman BACHUS. Deputy Comptroller Williams?

STATEMENT OF JULIE L. WILLIAMS, FIRST SENIOR DEPUTY COMPTROLLER AND CHIEF COUNSEL, OFFICE OF THE COMPTROLLER OF THE CURRENCY

Ms. WILLIAMS. Chairman Bachus and Members of the Subcommittee, I appreciate this opportunity to appear before you again to express the views of the Office of the Comptroller of the Currency on H.R. 1375. Let me also thank Congresswoman Capito again for sponsoring a bill that includes sensible and appropriate regulatory burden relief for national banks and for other financial institutions. Let me also note that we very much appreciate the courtesies extended by Committee staff as we and the other federal banking agencies have developed proposals and discussed issues with the staff leading up to today's hearing.

This morning I will highlight just a few of the provisions in the bill that we believe are especially important. My written testimony goes into additional detail and covers a number of other provisions.

The bill contains several provisions that streamline and modernize aspects of the corporate governance and interstate operations of national banks. We strongly support these measures. Although some may seem like relatively technical points, as Congresswoman Capito pointed out in her opening remarks, they can make a big difference in practice for banking institutions.

For example, the bill modifies the so-called qualifying shares requirement currently in the National Bank Act, which has made it difficult for some national banks to obtain favorable tax treatment as a Subchapter S corporation. The qualifying shares provision currently requires every national bank director to hold a minimum equity interest in his or her national bank. Because of this requirement, however, some national banks may end up with more shareholders than the law permits for a corporation wishing to elect Sub-S status. Community banks are most disadvantaged by this result.

The bill would solve this problem by authorizing the Comptroller to permit the directors of banks seeking Sub-S status to hold subordinated debt instead of equity securities. Holding subordinated debt would not cause a director to be counted as a shareholder for purposes of Subchapter S and would address the problem that I described.

A second important provision that has been added to the bill this year clarifies that the OCC may permit a national bank to organize

in business forms other than what is known as a body corporate. This may sound arcane, but if a national bank were able to organize as a limited liability national association, for example, the bank may be able to take advantage of the pass-through tax treatment that is available to comparable limited liability entities under certain tax laws. This would eliminate double taxation under which the same earnings are taxed both at the corporate level as corporate income and at the shareholder level as dividends.

Some States already permit state banks to be organized as unincorporated limited liability companies, and the FDICC has recently adopted a rule allowing state bank LLC's to qualify for deposit insurance if they meet certain conditions. This provision in the bill may be especially useful for community national banks, again, in the long run.

Another provision we strongly endorse repeals the requirement in current law that a State must affirmatively enact legislation in order to permit national and State banks to conduct interstate expansion through so-called de novo branching. Banks and their customers would benefit from this change, which would permit a bank to choose the form of interstate expansion that makes the most sense for its business needs and customer demand.

Federal thrifts have enjoyed this type of flexibility for decades. In today's internet age when customers can communicate remotely with banks located in any state, restrictions on where a bank may establish branch facilities in order to serve customers in person are an unnecessary legacy from a protectionist era that detracts from healthy competition and from customer service.

The bill also contains provisions that help enhance the safety and soundness of the banking system. For example, the bill expressly authorizes the agencies to enforce an institution-affiliated party's or a controlling shareholder's written commitment to provide capital to an insured depository institution. This provision would enable the agencies to hold parties to the capital commitments that they make and could help mitigate lawsuits against the deposit insurance funds.

Two other important new provisions have been added to the bill since last year that promote safety and soundness. First, the bill addresses the fact that independent contractors, such as accountants for insured depository institutions, are treated more leniently under the enforcement provisions in the current banking law than are directors, officers, employees, controlling shareholders and even agents for the institution. The bill addresses this disparity by holding independent contractors to a standard that is more like the standard that applies to other institution-affiliated parties.

The bill also addresses safety and soundness issues that have arisen for the banking regulators when a so-called stripped-charter institution is used to acquire a bank with deposit insurance through a Change in Bank Control Act notice without the prospective acquirer submitting an application for a new charter or an application for deposit insurance. The agency's primary concern with this type of Change in Bank Control Act notice is that the acquirer of the stripped charter is effectively buying a bank charter without the scope of safety and soundness review that the law requires when applicants seek a new charter and deposit insurance even

though the risks presented by the two sets of circumstances may be substantively identical.

In conclusion, as I noted, my written statement makes suggestions for some additional amendments to the current law that we believe would make useful improvements to the bill. We very much look forward to working with the Subcommittee and with the other federal banking agencies as the bill advances.

Mr. Chairman, Congresswoman Capito, on behalf of the OCC, we thank you for your support of this legislation. At the appropriate time I will be happy to answer any questions you may have.

[The prepared statement of Julie L. Williams can be found on page 134 in the appendix.]

Chairman BACHUS. Thank you.

Chief Counsel Kroener?

STATEMENT OF WILLIAM F. KROENER, III, GENERAL COUNSEL, FEDERAL DEPOSIT INSURANCE CORPORATION

Mr. KROENER. Thank you. Mr. Chairman, and Members of the Subcommittee, I appreciate the opportunity to present, again, the views of the Federal Deposit Insurance Corporation on proposed legislation to provide regulatory burden relief.

The FDICC shares the Subcommittee's continuing commitment to eliminate unnecessary burden and to streamline and modernize laws and regulations as the financial industry evolves. FDICC Vice Chairman John Reich is leading the Federal Financial Institutions Examination Council effort to conduct a thorough review of regulations to identify outdated and otherwise unnecessary ones.

This review, which is mandated by the Economic Growth and Regulatory Paperwork Reduction Act of 1996, is not due until 2006. By advancing it as we have, the FDICC sees it as an opportunity to reinforce ongoing efforts to lessen regulatory burden and identify other areas of regulatory overlap and inefficiencies. The FDICC is also leading interagency efforts to implement improved collection management and distribution of Call Report information using XBRL, a data standard for transporting and displaying financial reporting information using the Internet.

We are working with other regulators, accounting firms, software companies and financial services providers around the world to promote transparency, processing efficiency and improved risk management techniques using the new data standards.

The FDICC continues its extensive efforts to provide regulatory relief for the industry by streamlining examination processes and procedures with an eye toward better allocating FDICC resources to areas that could pose the greatest risk to the insurance funds. These FDICC efforts to reduce burden include targeted examinations based on the institution's risk profile. By use of risk focused examination procedures the FDICC has reduced the average time spent conducting risk management examinations in qualifying institutions by well over our original 20 percent goal.

Chairman Powell remains keenly interested in exploring all measures to eliminate inefficiencies and costs in the supervisory and regulatory systems. We have on our website an opportunity for institutions to suggest ways to reduce burden, and we take those suggestions seriously and follow-up on them as promptly as we can.

The FDICC commends the Subcommittee for holding this hearing and Representative Capito for introducing legislative changes to lessen the regulatory compliance burden on insured depository institutions. The FDICC staff worked closely with the Subcommittee staff in developing several of the provisions contained in the proposed legislation, including many that will help the FDICC become more efficient and effective in regulating insured institutions.

The FDICC enthusiastically supports the provisions in H.R. 1375 that we suggested for inclusion in the bill. The provisions that the FDICC endorses include:

(1) those that clarify that the agency may suspend or prohibit individuals from participation in the affairs of any depository institution and not solely the insured depository institution with which the individual is or was associated;

(2) those that specify the time period during which the appointment of the FDICC as conservator or receiver of a failed insured depository institution could be challenged;

(3) those that modify the requirement for retention of old records of a failed insured depository institution at the time a receiver is appointed;

(4) those that permit the FDICC to rely on records preserved electronically such as optically imaged or computer scanned images; and,

(5) those that clarify existing authority of the FDICC as receiver or conservator to enforce written conditions or agreements entered into between insured depository institutions and institution affiliated parties and controlling shareholders.

The FDICC also supports section 409 that amends the Change in Bank Control Act to address an issue that arises when a "stripped charter" institution is the subject of a change in control notice. This is the provision that Deputy Williams mentioned in her oral statement. Section 409 clarifies the base on which such notices may be disapproved and expands the base for extensions of time for considerations of notices raising novel or significant issues.

The FDICC also supports a number of the provisions that were requested by our fellow regulators here on the panel today and were included in the proposal. For example, the provisions that streamline merger application requirements and those that permit bank examiners to receive credit from any insured depository institution so long as it is on the same terms and conditions as credit offered to the general public.

The FDICC recommends that the Subcommittee include a number of additional regulatory relief items in the bill. For example, we recommend inclusion of language that provides each of the other federal banking agencies with express authority to take enforcement action against banks they supervise based on violations of conditions imposed by the FDICC in writing in connection with approval of an institution's application for deposit insurance. We also recommend amendments to the Bank Merger Act and Bank Holding Company Act to require consideration of potentially adverse effects on the insurance funds of any proposed bank merger transaction or holding company formation or acquisition and language that improves our ability to act as receiver of failed institutions—language that provides for the FDICC to gain access to individual

FICO scores to improve our ability to evaluate assets and recommend transaction structures for failing banks, and a provision to clarify the FDIC Act relating to the resolution of deposit insurance disputes in the case of failed insured depository institutions.

I have included the legislative language on these and several other provisions with my written statement. Thank you, again, for the opportunity to present the FDICC's views on these issues. The FDICC supports the Subcommittee's continued efforts to reduce unnecessary burden on insured depository institutions and we continually strive for efficiency in the regulatory process and are pleased to work with the Subcommittee in accomplishing this goal.

I look forward to your questions at the appropriate time, Mr. Chairman. Thank you.

[The prepared statement of William F. Kroener, III can be found on page 84 in the appendix.]

Chairman BACHUS. I thank the General Counsel.

Now, we will hear from Chief Counsel Buck.

STATEMENT OF CAROLYN BUCK, CHIEF COUNSEL, OFFICE OF THRIFT SUPERVISION

Ms. BUCK. Good morning, Mr. Chairman and members of the subcommittee. Thank you for the opportunity on behalf of OTS to testify on H.R. 1375, the Financial Services Regulatory Relief Act of 2003 sponsored by Congresswoman Capito and Congressman Ross. I commend them on the bill and their efforts to reduce regulatory burden on depository institutions.

During periods of economic uncertainty it is particularly important that we make every effort to remove unnecessary regulatory obstacles that divert valuable resources and hinder innovation and competition in our financial services industry. In my written testimony I discuss a number of proposals that we believe would significantly reduce burden on thrift institutions. And I ask that the full text of that statement be included in the record.

Today, I will highlight the portion of H.R. 1375 that would provide the most significant relief to thrifts. These are the proposed amendments that would treat thrifts and banks the same under the federal securities laws. Banks and thrifts may engage in the same types of activities covered by the investment advisor and broker dealer requirements of the federal securities laws. And these activities are subject to substantially similar supervision by OTS and bank regulators. The key point is that banks, but not thrifts, are exempt from registration under the Investment Advisors Act of 1940 and banks, but not thrifts, enjoy an exemption from broker dealer registration under the 1934 act for certain activities specified in the Gramm-Leach-Bliley Act. For purposes of the broker dealer requirements the SEC does treat thrifts the same as banks. That is the commission has exercised its exceptive authority, for now, to treat thrifts the same as banks. But the SEC has not extended that same parity to the investment advisor requirements. We believe that treating thrifts and banks the same under the federal securities laws makes sense for a number of reasons. Thrifts fill an important niche in the financial services arena by focusing their activities primarily on residential, community, small business and consumer lending. The Homeowners Loan Act

allows thrifts to provide trust and custody services on the same basis as national banks, and investment advisor and third party brokerage in the same manner as banks. Not only are the authorized activities the same, but OTS examines activities in the same manner as the other banking agencies.

While the bank and thrift charters are tailored to provide powers focused on different business strategies, in areas where the powers are similar, the rules should be similar. No legitimate public policy rationale is serviced by imposing additional and superfluous administrative costs on thrifts to register as an investment advisor or broker dealer when banks are exempt from registration. There should be similar treatments for regulated entities under similar circumstances.

And the circumstances here are that, first, thrifts, like banks, have a regulator that specifically supervises the type of activities covered by the investment advisor and broker dealer registration requirements. Second, thrifts, like banks, are subject to the same functional regulatory scheme that was endorsed by the Gramm-Leach-Bliley Act. And, third, thrifts, like banks, are subject to substantially similar customer protections with respect to the activities covered by the registration requirements, which, by the way, are based on the SEC's own customer protection rules.

The only difference is that thrift, unlike banks, are subject to an additional and clearly burdensome administrative registration requirement. As best stated in the SEC's own words, from the preamble to their May 2001 interim rule extending broker dealer parity to thrifts, quote, insured savings associations are subject to a similar regulatory structure and examination standard as banks. Extending the exemption for banks to savings associations and savings banks is necessary or appropriate in the public interest and is consistent with the protection of investors. End quote. We could not have said this better ourselves.

For that reason, OTS strongly supports the amendments in H.R. 1375 to extend the bank registration exemption to thrifts. Absent this treatment, thrifts are placed at a competitive disadvantage that is without merit and that imposes significant regulatory costs and burdens. As recently as the Gramm-Leach-Bliley Act, Congress affirmed the principles underlying the bank registration exemption. We believe the best way to resolve this matter for thrifts with certainty and finality is for Congress to extend by statute the same exemption to thrifts.

This would also have the beneficial effect of avoiding the need for a series of SEC administrative exemptions as the need arises, another potential regulatory burden. OTS itself is committed to reducing burden whenever it has the ability to do so, consistent with safety and soundness and compliance with law. The proposed legislation advances this objective and we appreciate that many of the reforms that we have long desired are included in the bill.

I especially thank you, Mr. Chairman, Congresswoman Capito, Congressman Ross and all the others who have shown leadership on this issue and we look forward to working with the subcommittee on this legislation. Thank you.

[The prepared statement of Carolyn Buck can be found on page 49 in the appendix.]

Chairman BACHUS. Thank you.

And, Mr. Gee, and it is Director Gee, I pronounced your name Gee when I introduced you. We have a Gee's Bend in Alabama and it is spelled the same way, so I guess in Mississippi it may be Gee, but everywhere else it is probably Gee.

STATEMENT OF GAVIN M. GEE, DIRECTOR OF FINANCE, IDAHO DEPARTMENT OF FINANCE, ON BEHALF OF THE CONFERENCE OF STATE BANK SUPERVISORS

Mr. GEE. That is fine, Mr. Chairman. I have been called much worse.

Good morning, Mr. Chairman and members of the subcommittee. My name is Gavin Gee I am the Idaho Director of the Department of Finance and Chairman of the Conference of State Banks Supervisors. Thank you for asking us to be here today and to share the view of CSBS, the Conference of State Bank Supervisors, on regulatory burden reduction and the Financial Services Regulatory Relief Act of 2003. And, thanks also to Representatives Capito and Ross for your hard work on this legislation. We applaud your efforts to reduce the burdens imposed by unnecessary or duplicative regulations that do not advance the safety and soundness of the nation's financial institutions.

The most important contribution toward reducing regulatory burden may be empowering the State banking system. State banks and State chartering system have created the vast majority of innovations in banking products, services and business structures. For this reason we are disappointed that a provision to allow State chartered member banks to utilize the powers of their charter is not included in the bill. Through innovation, coordination and the dynamic use of technology, States have made great strides in reducing regulatory burden for the institutions that we supervise.

My submitted testimony describes these efforts in much more detail. The Financial Services Regulatory Relief Act of 2003 can be a valuable federal compliment to these efforts. With respect to interstate branching requirements, as you may know, current Federal law has taken an inconsistent toward to how banks may branch across State lines. While Riegle-Neal gave the appearance that States could control how banks may enter and branch within their borders, this has not always been the reality. Perhaps, because it was believed that the federal thrift charter would be eliminated at the time Riegle-Neal was adopted, the law was not applied to federally chartered thrifts. The result is, that a federal thrift can branch without regard to State law and rules of entry. Since the passage of Riegle-Neal, the OCC has promulgated creative interpretations of the National Banks Act that effectively circumvent the application of Riegle-Neal to branch-like operations.

The result is that State chartered institutions, particularly community banks wishing to branch interstate are at a competitive disadvantage to those institutions that can use federal options to branch without restrictions. Presently, only 17 States now allow de novo branching. Whatever the outcome of your review of Federal law, we urge Congress to eliminate the disadvantage it has created for State banks because of the inconsistent application of Federal law.

CSBS also hopes that the committee will rethink, including the State member bank powers amendment. There is a detailed discussion of the amendment in my written testimony. Additionally, we encourage the committee to work with the Internal Revenue Service to reconsider its interpretation of the tax status of State chartered banks structured as limited liability corporations. While we understand that tax issues are not in the committee's jurisdiction, this would be meaningful regulatory relief for community banks.

CSBS believes that improved coordination and cooperation between regulators should be a cornerstone of regulatory relief. In that spirit, we suggest that Congress could improve the Federal Financial Institutions Examination Counsel by changing the State position from one of observer to that of full voting member. We also ask the committee and Congress to address the implementation and implications of regulatory preemption by the Office of the Comptroller of the Currency and the Office of Thrift Supervision. CSBS believes this request for review of preemption and applicable law is appropriately a regulatory burden reduction matter as well. Our banking system is a complex and evolving web of State and Federal law, particularly for State chartered institutions. Greater sunshine on OCC and OTS interpretations of applicable law for the institutions they charter would also help clarify applicable law for our nation's more than 6,000 State chartered banks representing nearly 70 percent of all insured depositories.

A clear articulation of OCC and OTS standards of preemption would also lessen the legal burden of litigation over the federal regulators sometimes-tenuous interpretations of federal law.

In conclusion, the quest to streamline the regulatory process while preserving the safety and soundness of our nation's financial system is critical to our economic well-being and to the health of our nation's financial institutions. We commend this committee for its efforts in this area.

Thank you for the opportunity to testify on this important subject. And we look forward to any questions that you and members of the subcommittee might have. Thank you.

[The prepared statement of Gavin M. Gee can be found on page 69 in the appendix.]

Chairman BACHUS. Thank you. And, for the record that was four minutes and 53 seconds. You have the record right now.

Administrator Lattimore, we welcome you.

STATEMENT OF JERRIE J. LATTIMORE, ADMINISTRATOR, CREDIT UNION DIVISION, STATE OF NORTH CAROLINA, ON BEHALF OF THE NATIONAL ASSOCIATION OF STATE CREDIT UNION SUPERVISORS

Ms. LATTIMORE. Thank you, Mr. Chairman and members of the subcommittee. My name is Jerrie J. Lattimore. I am the North Carolina Regulator for State chartered Credit Unions and the Chairman of NASCUS; NASCUS is the National Association of State Credit Union Supervisors. We regulate 4,300 State chartered credit unions throughout the United States, which is almost 50 percent of all the credit unions.

NASCUS is supportive of your efforts to reduce regulatory burden. I will comment today on those aspects of H.R. 1375 that di-

rectly impact State chartered credit unions and also would suggest some further revisions to the Federal Credit Union Act as outlined in our letter to Chairman Oxley dated January 23, 2003.

Section 301 of H.R. 1375 would authorize State chartered privately insured credit unions to be eligible for membership in the Federal Home Loan Banks. Expanding the field of institutions eligible for membership in no way alters the vigorous credit underwriting standards that an institution must meet in order to join the Federal Home Loan Bank or receive an advance. In addition, every Federal Home Loan Bank advance is fully secured by marketable collateral. It is our understanding that none of the banks has ever had a loss on an advance. This provision would allow qualified institutions to have an additional source of credit to use for the purpose of extending homeownership to their members. We urge the committee to approve this provision of the bill that would help achieve our nation's goals of homeownership.

Secondly, Section 313, NASCUS supports that section that would provide credit union's relief from the SEC registration requirements. The NCUA has endorsed provisions of this bill that would grant parity of treatment to all Federal and State federally insured credit unions and has previously submitted language to that effect.

NASCUS would urge the committee to approve such a provision for all State chartered credit unions. It should be clearly understood that this provision does not create any new powers for State chartered credit unions.

There are two other legislative issues that NASCUS would like for this committee to consider. The first is relief from member business loan constraints that were added by the Senate to the Credit Union Member Access Act of 1998. Historically, many credit unions have provided loans for their members' business purposes. Member business lending not only meets the credit needs of the member, but also serves as a valuable source of financing for community development and local job creation.

Credit unions are not in the business of lending to foreign corporations or governments. Their business loans are made locally and the funds recycle throughout the community. In an economic environment where entire industries are severely affected, businesses are closing and jobs are being lost, these member business loans are vital to the economy.

NASCUS would urge that the restrictions on member business lending be removed from the Federal Credit Union Act for State chartered credit unions and returned to the State legislators and the credit union supervisors to regulate. If that solution is not acceptable, NASCUS would then urge that credit unions be granted business lending authority equivalent to that proposed for federal savings institutions, that is, the asset limitation contained in the Federal Credit Union Act for business loans should be raised from 12.25 percent to 20 percent, which is the same percentage proposed for federal savings associations.

Secondly, micro member business loans that are less than the Fannie Mae and Freddie Mac ceiling, which is roughly $322,000, be excluded from the member business loan definition.

The second issue is to permit credit unions to include supplemental capital as part of net worth for prompt corrective action.

The combination of prompt corrective action requirements established by Congress in 1998 and the subsequent rapid deposit growth has created a financial and regulatory dilemma for many State chartered credit unions. PCA net worth requirements are higher for credit unions than they are for all other financial institutions. All types of financial institutions currently employ supplemental capital in some form. It is already authorized for low-income and corporate credit unions. All credit unions should be afforded the use of supplemental capital if they so desire. With the flight to quality from the stock market, many credit unions are experiencing rapid share growth, which results in reduced net worth ratios. It makes good business sense to include other forms of capital that lend additional soundness to an institution. We should take every financially feasible step to strengthen this nation's credit unions, which, in turn, strengthens the financial condition of its members.

To further support this proposition I have a Filene Research Institute Study done by Dr. James Wilcox of the University of California at Berkley. His conclusion was that marketing of subordinated debt would require increased transparency and disclosure about a credit union's financial condition. And it would create a larger cushion for the share insurance fund. Subordinated debt would impose an element of direct market discipline on the industry. This study is lengthy. I will not submit it for the record. But, I do have it for any members of the committee, who would like a copy.

During the last Congress, Representatives Brad Sherman and Robert Ney introduced amendments addressing supplemental capital and we hope these amendments will be enacted during this session. Again, we thank you very much for this opportunity to testify and we look forward to helping this subcommittee in any way that we can.

Thank you.

[The prepared statement of Jerrie J. Lattimore can be found on page 114 in the appendix.]

Chairman BACHUS. Thank you.

I have got one brief question I am going to ask Mr. Gee. And then I am going to surrender the balance of my time to Ms. Capito.

You talked about a possible disadvantage of a State chartered institution branching across State lines and I want to address that. You talked about the improvements in coordination between the State regulators to support interstate operations. We have received a proposal, which would give greater certainty to State charters operating interstate reflecting the current state cooperative agreements signed by all the States. Does the Conference of State Banking Supervisors support that amendment? Are you aware of it and do you support it?

Mr. GEE. Thank you, Mr. Chairman, for the question. You mentioned the interstate cooperative agreements, and yes these agreements have been in place, I believe, since about 1994. Generally they have worked very well among the States. We work to provide seamless supervision, a single point of contact. We have similar agreements with the federal agencies to provide the same thing. And I would have to say from our perspective, for the most part,

those work very well on an interstate environment. We are aware of these proposals. And, to answer your question specifically, yes, we do support them. We would look forward to providing greater certainty for those banks that are, I guess, either uncomfortable with just the cooperative agreement that are essentially voluntary cooperative agreements. They do not have the force and effective law. So, we would be very interested in working with the committee and you, Mr. Chairman, on those proposals, and, yes, we would support them.

Chairman BACHUS. Thank you. And I know that there is some controversy. Mr. Hensarling was here earlier and I know he has some interest in the State of Texas. I am not sure that it will be in this legislation.

Ms. Capito?

Mrs. CAPITO. Thank you, Mr. Chairman.

And, thank you all for your testimony.

I would like to ask Governor Olson a question as to the shortening of the post-approval waiting period for bank mergers. In some of the opening statements, it was alluded to and I would like for your clarification on this. Would you describe the review process and the waiting periods? And, it is my understanding the Attorney General would have to sign off on this before the five-day waiting period would go into effect.

Mr. OLSON. You are correct, Congresswoman. The process, the application process is a lengthy and very time-consuming process and there is a lot of input that is received regarding all of the implications of the application. After the approval has been made by all of the appropriate regulatory authorities there is then a time period that is allowed for the U.S. Attorney General to determine if there are any anti-trust implications in it. That is a 30-day period that can now be reduced to 15 days.

And we are suggesting that when, and only when, the Attorney General indicates that there are no anti-competitive implications of the merger, that then it could be reduced to a five-day period.

Mrs. CAPITO. But, in no way would it affect the overview oversight?

Mr. OLSON. It does not. This is post-application approval, during which time it is the time period allowed only for the Attorney General to respond.

Mrs. CAPITO. Thank you.

I have a question for Chairman Dollar. You support Section 313, which exempts the federally insured credit unions from certain broker dealer, and you spoke about this in your opening statement. You point out that this is—this exemption will have somewhat more limited application to credit unions than to other depository institutions. There is some concern from others about this provision. Would you explain how the exemption would apply in the credit union context and why it is more limited at scope and how does NCUA oversee investment and advisor activities specifically regarding disclosure and level of competency?

Mr. DOLLAR. Well, Congresswoman, the primary reason why it is not as in broad scope as other financial institutions is that credit unions are limited by law as far as the types of services they can

provide. And nothing in this provision, as you well know, expands in any way the authorities that credit unions are able to offer.

I think that the reason that this, of course, comes to the forefront, the reason that it has been included in the bill is because the parity provision that was provided for the thrifts was then brought to bear for credit unions as well. And I think that this is appropriate because there is a burdensome nature to the registration as a broker dealer. When all you are going to be doing is basic safekeeping, serving as a depository, or holding of items that the credit unions are authorized to do. Credit unions that might buy a municipal bond and decide that they are going to hold it in their portfolio rather than having it held by another broker or safe keeper. Certainly there are some sweep account arrangements that credit unions do that are very basic de minimus type of activities that they are able to do that we just feel like it would be very burdensome for them to have to register as an SEC—with SEC as a broker dealer to be able to do that. But, this does not, you are correct, in anyway increase credit union authorities in any areas of investment services or brokerage services that they do not presently have the legal authority to offer.

Mrs. CAPITO. Okay. Thank you.

And I would like to ask Ms. Buck the same question. I know you addressed this in your opening statement. In terms of disclosure or level of competency, do you see this having an impact?

Ms. BUCK. No, it does not, Congresswoman Capito. We have, just in the last two years, updated all of our examination guidance on these kinds of activities so that they would be equivalent to what is provided in the national bank context and last year we updated our regulation applying to securities and record keeping requirements for entities that are engaged in these kind of activities, again, to make them consistent to those that apply in the bank context.

We have a regular examination process. We examine every one of our institutions on anywhere from a 12 to 18 month basis, so we are taking look at the kinds of activities they are engaging in and making sure that they are complying with laws. So, I do not see any diminution of customer protections in these activities.

Mrs. CAPITO. Thank you.

I would like to ask Ms. Lattimore along the same lines. Do State Regulators oversee this investment advisor activities in terms of competency and disclosure? Do you have any role in that?

Ms. LATTIMORE. We do. We oversee all parts of the credit unions in every business that they are—and every investment that they are involved in. But, as Mr. Dollar pointed out, the credit union's role is much more limited just by its very nature.

Mrs. CAPITO. And I have one final question again for Governor Olson. There is a section that is related to insider lending. And, would you explain what the reporting requirements are and why they should be eliminated? My understanding is there is duplication, but if you could just explain it.

Mr. OLSON. Well, let me first talk about what they do not alter. They do not alter in any way any of the regulation provisions, and they do not alter any way any of the rules regarding insider lending. But, there are three separate reports that are required now,

one of which is a report for loans by an executive offices of a bank from another bank in excess of the lending limit of that bank. Another involves loans that are made between reporting periods. And another involves the report that I cannot—I do not have the third one right in front of me, but I can find it for you real quickly if you would like.

In each case they are reports that, in our judgment, do not contribute to or assist us in the enforcement of the insider lending provisions, but are simply additional reports that are required under the statute.

Mrs. CAPITO. Thank you. I would say in the sense of the bill in terms of being common sense regulatory reforms, certainly in eliminating duplication is one of our goals here, but certainly not any kind of lessening of enforcement powers or in any of the areas that we have discussed today.

Mr. OLSON. That is an important clarification. And this does not in any way reduce any of the impact of the insider lending laws, which we take very seriously.

Mrs. CAPITO. Thank you.

I have no further questions. Thank you.

Chairman BACHUS. Thank you.

Ms. Waters?

Ms. WATERS. I thank you very much, Mr. Chairman. I am sorry that I could not be here for the entire hearing. But, I thank all of the representatives of the regulators that are here. I have a lot of questions. I cannot possibly ask them all. But, let me target a little in on payday lending.

As you know, payday lending is a big concern of some of us who represent districts where these operations are proliferating. As I understand it at OCC you have some oversight when they are connected to a national bank. How do you feel about banks renting their charters or allowing their preemption privileges to be rented or purchased by payday lending? Should this practice continue or should we try and outlaw that practice all together?

Ms. WILLIAMS. Congresswoman, we have very, very strong feelings against the so-called rent-a-charter relationships that we have seen. We had four situations, not a whole lot, where we had national banks that entered into contractual arrangements with payday lenders. As a policy matter, those arrangements raised substantial concerns in the rent-a-charter category that you described. I think it is important to also emphasize that as a supervisory matter, the way in which those arrangements were actually being conducted, the way in which the banks were conducting their operations, the way in which customers were being treated pursuant to those arrangements, raised very, very substantial safety and soundness and compliance issues. We have taken consensual enforcement actions in all of those four cases, and there are no longer any national banks——

Ms. WATERS. I appreciate that, but I do not have a lot of time. Should we outlaw the practice all together?

Ms. WILLIAMS. I am not sure how you would specifically define a rent-a-charter arrangement; that might be challenging.

Ms. WATERS. All right. Let me ask some of these payday loan operations have operations in more than one State.

Ms. WILLIAMS. That is correct.

Ms. WATERS. The definition of a national bank is a bank that has chapters or operations in more than one state.

Ms. WILLIAMS. Not necessarily. We have many national banks that are located in multiple states, but we have many community national banks that are locally based.

Ms. WATERS. If, in fact, we are not sure about whether or not we should outlaw the practice all together because it is hard to define, should we then preempt the states and take under supervision payday loans, particularly where they are interstate operations?

Ms. WILLIAMS. I think that raises the larger question of creating a federal standard with respect to payday lending, if I am understanding you correctly.

Ms. WATERS. Yes.

Ms. WILLIAMS. That in and of itself raises some issues, but that certainly would be one way to go at the problem.

Ms. WATERS. Would you favor if we could do nothing else but disallow the practice of postdated checks in these transactions?

Ms. WILLIAMS. I am not sure if I understand the——

Ms. WATERS. When pay lenders operate in such a way that when they make these small loans they had to borrow, make out a postdated check for the interest and the principal. So, that if it is $100, as indicated in some of the information we have today, it would be $115. When they come back to repay it two weeks later, if they do not have that money they can roll it over, roll it over, roll it over and I am really interested in what we can do about interfering with the ability for these rollovers that increase the amount of the loan to sometimes 1,000 percent interest rates or something like that.

Ms. WILLIAMS. I think that one of the areas where the abuses are most notable is where you have multiple rollover situations, and that would be one way to go at it. And, if you are focusing just on the use of the postdated check as the vehicle for the payday loan, I think one important thing to note here is that there can be different ways that one structures a payday loan product. I would not want to foreclose the possibility that you could have a small denomination loan product that would not be abusive.

Ms. WATERS. Would you favor putting a limit to the number of rollovers that could be done in one of these kinds of loans?

Ms. WILLIAMS. When we looked at the characteristics of payday lending, we thought that would be one area that would be most promising to avoid abuses. Yes, Congresswoman.

Ms. WATERS. I am going to be looking for something in legislation that is going to deal with the abuses of the payday loan industry. And while your oversight is very limited to those national banks who rent their charters, I certainly hope you would help to give us some assistance and leadership to do something about this terrible practice.

Ms. WILLIAMS. I think probably all of the banking agencies would be very interested in providing what they know about how this affects their regulated institutions if you want to pursue that.

Ms. WATERS. That is some help in the legislation. Thank you.

Thank you very much, Mr. Chairman.

Chairman BACHUS. Thank you.

Mr. Bereuter?

Mr. BEREUTER. Thank you, Mr. Chairman. I want to thank the witnesses for their testimony today as we consider this important legislation.

Prefatory to my questions, I want to say that I think that one of the reasons the stock market is doing so badly, one of the reasons are economic recovery is being delayed is because of lack of investor confidence. They are concerned about high profile abuses in corporate governance and they are concerned about abuses and incestuous relationships between the securities industry and the corporations whose stock they are attempting to advise their clients on.

And, so, following up the kind of question that Ms. Capito asked to Chairman Dollar, I would like to pursue that area a bit with two other panel witnesses. First, Ms. Buck, the OTS supports Section 201, according to your testimony, which exempts thrifts from broker dealers and investment advisor registration requirements. How would the OTS oversee investment advisors' activities specifically regarding disclosure and level of competence?

Ms. BUCK. As I was explaining, we have regular examinations that we conduct on 12 to 18-month basis. Initially when the institution or entity comes to us and either asks to engage in trust powers if it is an entity we already regulate, or if an institution or entity comes and want to obtain a thrift chart and wants to engage in trust activities, we look very closely at the competence of the individuals who will be running those operations and determine that they do have the ability both to manage the asset and to provide the necessary protections for the customers. In fact, there are times when we would not allow them to open until we are sure that they have those people on staff and ready to operate.

As far as the customer protection requirements are involved, we do look at these for compliance with our own regulations and our handbook requirements on assuring that customers understand that the individuals who are operating the thrift are disclosing any conflicts of interest and are conducting the other kinds of disclosures that are necessary for the customers.

Mr. BEREUTER. Is the OTS prepared to exercise this regulatory authority very aggressively, especially in light of all the lack of consumer investor confidence?

Ms. BUCK. Yes, we are. We have approximately 100 institutions right now that have trust powers and we have expanded both the number of examiners who are experienced in this and we have expanded our training in this area to make sure that we are fully capable of overseeing this activity.

Mr. BEREUTER. Thank you.

I would like to ask related questions to Administrator Lattimore. You support Section 313, which gives both federal and State chartered credit unions an exemption from broker dealer and investment advisory requirements. Why should we have the confidence in state-by-state quality of regulatory oversight?

Ms. LATTIMORE. I do not know why there would be a lack of confidence. The state supervisors are very diligent in carrying out their duties. We have a responsibility to the citizens of our State to be sure that the financial institutions that we regulate are close-

ly regulated. We take action when it is necessary. If such a new program were instituted we would carefully examine that program and, as Ms. Buck said, if they were—if we did not feel like the institution could offer the services we would not allow them to do it. But, I think State chartered credit unions are as well regulated as other credit unions. And, certainly the numbers prove that out.

Mr. BEREUTER. Do you understand my point of view? I think it is representative of a lot of people that you have to pursue this very aggressively if you have this responsibility.

Ms. LATTIMORE. Yes, sir. And, we would take that responsibility very seriously. Our credit unions are owned by the members. That is what makes them very unique. And we cannot allow credit unions to offer anything to their own membership that owns them that is not completely on the up and up. So, the members would not stand for it. And, that would create real problems in the credit union, that is why we would ask to take it and would take it very seriously.

Mr. BEREUTER. Thank you very much.

Director Gee, I have an unrelated question. There are some 33 States that do not allow de novo interstate branching, I believe, something like that, 33 States. Yet, you say in your testimony we appreciate your revisiting the Riegle-Neal Act and we urge Congress to eliminate the disadvantage it is created for state banks because of inconsistent application of federal law. I am kind of surprised that that point of view is offered for you in behalf of the people you are representing today. Can you explain?

Mr. GEE. Yes, Representative. Thank you for the question. As I commented in my remarks, and there is more detail in my written comments, the biggest problem is that the state charter is disadvantaged. Right now, federally chartered thrifts, federally chartered credit unions, largely national banks, can branch interstate. And, so, this puts the state charter, the State chartered bank at a disadvantage. They do not have the ability to do that in most states and, because of those interpretations of federal law and because of the application of federal law. And in many States they would like to have that ability especially community banks where they are on the border or near the border of another State to be able to branch across the State line. But, we see it as a charter disadvantage for the State charter and only for the State chartered bank, because virtually every other charter has the ability to engage in that activity across State lines.

Mr. BEREUTER. It is a disadvantage. But, would you admit that some States are not in favor of de novo branch banking in general for any kind of institutions, federal or State chartered?

Mr. GEE. I would absolutely agree with you. The problem is, that because the other charters do have that ability it creates a disadvantage for our charter, for the state bank charter, and we do not like to see our State bank charters disadvantaged.

Mr. BEREUTER. Mr. Chairman, thank you very much.

Chairman BACHUS. See, I told you it was controversial. I told you that might be a controversial.

Mr. Watt, the gentleman from North Carolina?

Mr. WATT. Thank you, Mr. Chairman. And, I want to do two things preliminarily. First of all apologize to the witnesses for not

being able to be here for all of your testimony. Unfortunately, I had to do something on the floor of the House and could not get here until I did. And, second, thank all of you for being here, particularly Ms. Lattimore who does such a find job in the State of North Carolina from whence I hail, and welcome her in particular, not that I am not welcoming everybody else too.

Ms. Lattimore has put a couple of things on the table that I want to get reactions of other panel members to. The first one has to do with the desire of credit unions to do business loans to their members. And, I am wondering two things about that.

Number one, Mr. Kroener, whether that would have any deposit insurance implications and if so, what they are.

And the second thing I am wondering for anybody else on the panel who might have a position on it is whether there are any policy differences that would come into play, is that a good idea, if there is anybody on the panel who has a different perspective about whether it is a good idea as a policy perspective.

So, Mr. Kroener, first deposit insurance implications. And, second, anybody who might have a different policy perspective.

Mr. KROENER. I thank you for the question, Congressman Watt. From a deposit insurance perspective, we do not, at least any longer—I think we did in the 1940s—insure credit unions. We insure banks and theifts. So, you are talking about a group of institutions that the FDICC does not insure. So, any deposit insurance implications would be quite indirect instead of direct for that reason. There has been general concern among the institutions we insure about the competitive parity between banks, insured banks as a group and credit unions because of their different tax status. But, that would be quite remote, quite indirect. This would impact that competitive parity I think.

But, even those are quite remote from any implications from a deposit insurance standpoint. But, I defer to others on the panel if they care to add anything.

Mr. DOLLAR. Congressman, if I might and the NCUA is the agency that insures federally insured credit unions.

Mr. WATT. I got the wrong person to ask the question to, I am sorry.

Mr. DOLLAR. That is quite all right.

Mr. WATT. Sorry about that.

Mr. DOLLAR. I whispered to Bill that he could kick it to me if he wanted to and I do not think he got my whisper. But, let me just say that we are of the belief that there needs to be more start up entrepreneurial capital in this country, not less. And there needs to be more access to it, not less. And we believe that credit unions are a viable source for small start up entrepreneurial capital. We call it member business lending. That is a distinction from commercial lending as we may know it in the traditional financial institutions.

Mr. WATT. Where would you draw that line? I mean, how do you draw that line?

Mr. DOLLAR. Well, Congress drew the line in 1998 when Congress said that anything below $50,000 did not have to count as a member business loan. We actually believe, though, that as the credit union community begins to extend itself more and more as

it is into underserved communities, one of the advantages of the field of membership law that you passed in 1998 enabled credit unions to adopt underserved areas into their field of membership, which they have done by record numbers, over 40 million Americans living in underserved areas that were not eligible to join a credit union two years ago are now eligible to join. We think if those credit unions are going to really make a true difference in those communities they have to be more than merely an alternative to the payday lenders.

Mr. WATT. So, you think it is a good idea. I do not mean to rush you. I just want to make sure I get to the second——

Mr. DOLLAR. I think it is a great idea.

Mr. WATT. ——the policy side of this before I run out of time.

Mr. DOLLAR. But, the one size fits all statute that you have in place which limits credit unions to 12.25 percent of their total assets in member business loans is thwarting many credit unions who would like to offer those small business start up loans.

Mr. WATT. Okay. Does anybody have a response on the other policy issue?

Mr. OLSON. Congressman, on behalf of the Federal Reserve Board, we have not taken a position on that issue.

Mr. WATT. Has any of the regulators taken a position on it or they—you all want us to grapple with it? Okay.

All right. Well, I thank you. I am just trying to figure out where people—the various regulators stand on these things. I appreciate it.

I yield back.

Chairman BACHUS. Instead of alternating, I am going to go to Ms. Maloney. She has been here quite some time and then I will——

Mrs. MALONEY. I thank you, Mr. Chairman. And I have to mention your positive role in deposit reform. And I understand it is going to be on the floor next week. So, congratulations on your leadership on that.

And I thank Mr. Bereuter on the help that we—the work we did together to make sure that banks pass credit with observed included in the bill.

I want to thank the sponsors of this legislation for putting this package together. And I am very supportive of the bill and regulatory relief efforts in general, provided it does not endanger the safety and soundness of the financial system. And, I have a few brief questions about certain sections in the bill and I would like to ask each panelist to respond with their views as to whether these sections will in anyway affect safety and soundness.

I do want to make it clear that I supported the legislation last year and it is not my view that the bill negatively affects safety and soundness. However, I believe that it is very important to hear from the regulators and to have your points of view placed on record on this issue.

First, Ms. Williams, Section 601 of the bill allows the OCC to adjust its mandatory examination schedule to concentrate examination resources on troubled or risking institutions. And what is the impact of this provision on safety and soundness?

Ms. WILLIAMS. Just to clarify at the outset, it is not limited to the OCC; the flexibility would be available for all of the federal banking agencies. I would hope that the impact of the change would actually be to enhance safety and soundness. It is designed to accomplish that purpose. It would give the regulatory agencies a little more flexibility in scheduling their exams so that they can concentrate their resources on particularly troubled or risky institutions and institutions with emerging problems. None of us intend or envision that this would result in any substantial slippage in the exam schedules, but it will give us a little bit more flexibility in order to tailor where the exam resources are used in order to address the highest risks in the system. So, I think it would enhance safety and soundness.

Mrs. MALONEY. Okay. Thank you.

Chairman Dollar, I want to thank the credit unions for providing the financial services in many areas of districts that I have represented that had really no banks there, really. It was the only source of banking services, loans and so forth. But, I would like you to address the impact of Section 308, which repeals the requirement that groups of over 3,000 be spun off into new credit unions during mergers and the impact of Section 303, which relaxes some restrictions on credit union investments and what is this impact, if any, on safety and soundness?

Mr. DOLLAR. Let me start with the first one as it relates to the merger authority. In actuality I believe that it would have an adverse effect upon safety and soundness if you have two credit unions that sought to merge and we were to intervene regulatorily to say that before you can merge you have to spin off one of your larger groups because they might or might not be viable enough to charter a credit union on their own. They had already made the business decision to affiliate with the existing credit union that is being merged. So, actually the present situation, which requires us to evaluate the possibility of a spin off has potentially more adverse safety and soundness ramifications than it would with what the bill has provided and that is to say that a spin-off of a group is not required.

From the safety and soundness perspective as it relates to investment authorities, the investment authority basically that we are looking for and that the language of Section 303 provides is very strictly drawn, very conservative in nature, very consistent with the types of investments that credit unions presently are authorized to make. The only thing we are asking is if some of the investments that have proven to be very conservative and workable at the state level be also authorized for federally chartered credit unions.

Mrs. MALONEY. Thank you.

Thank you and my time is almost up, but Governor Olson, Section 404 raises the restriction on the size of institutions that can have common management officials and are you confident that this will not lead to business loans to bank insiders that could endanger safety and soundness?

Mr. OLSON. Congresswoman, there was a provision put in the law in 1978 allowing for overlapping directors only in standard metropolitan areas, MSA's, where the institutions were very small.

And it addressed the issue of small banks being able to attract directors who would be helpful to them in the management of that institution. $20 million was the figure that was put in in 1978, we are suggesting $100 million at this point. If we raise it every 25 years or so, which is what the request would be, we think an appropriate level would be to go to $100 million at this point.

Mrs. MALONEY. Thank you very much. My time is up.

Chairman BACHUS. Thank you.

Mr. Sherman?

Mr. SHERMAN. Thank you.

Mr. Dollar, during the consideration of the regulatory relief at the full committee last year, Representative Nye and myself offered an amendment dealing with supplemental capital. And this would have allowed credit unions to apply secondary capital to their net worth for purposes of meeting the minimum net worth ratio requirements mandated by the prompt corrective action regulations. This supplemental capital would be similar to that available by banks, to banks, rather, by the Office of Comptroller of the Currency in determining the definitions of capital. It is allowed to low income credit unions. They can get supplemental capital. I would like to know whether you think that this is an effective way of allowing credit unions to service their existing customers and accept new customers and whether there has been any problem with the use of supplemental capital by low-income credit unions?

Mr. DOLLAR. Thank you, Congressman. Indeed, as you are aware, Congress in 1998, when you passed the Credit Union Membership Access Act defined in the prompt correction action section of the law, what can count as net worth for credit unions, which was retained earnings only. That was a public policy decision that Congress made at that time. It has been suggested by some credit unions, particularly those that, as a result of deposit growth, may be bumping against some of those prompt corrective action guidelines that an alternative for an additional buffer might be secondary capital.

Certainly, as the regulator who is responsible for protecting the share insurance fund, which is the buffer against the taxpayers and when net worth is the buffer against the share insurance fund, anything that might provide an additional buffer we would be more than willing to sit down with the committee and work on.

But, I am sure that you are aware that the concept of secondary capital for credit unions is quite controversial, both within the credit union community and outside the credit union community. There are issues that we would have to address that we would be willing to work with you on, such as should it be limited to only members of credit unions or could non-members be able to purchase this subordinated debt? Can you restrict one credit union who receives supplemental capital from being able to then deposit in another institution's supplemental capital where you might have one credit union take the same a million dollars, deposit it in this one, then this one deposits in this one and 25 credit unions pass around the same million dollars, all of them counting it in their net worth. There are issues that would have to be addressed.

Mr. SHERMAN. That we would clearly—since it is quite possible that we will reintroduce an amendment this year, I would hope

that your office would provide us with language that might solve that problem.

Mr. DOLLAR. We would be glad to work with you. If you and the Congress are interested in pursuing this public policy decision of reexamining PCA in this regard, we would be glad to work with you. And may I just quickly say that if we are going to look at reexamining PCA, one of the issues we may want to look at is whether or not PCA should be made risk based instead of based upon total assets as it presently is. Prior to 1998, credit unions reserved based upon their risk assets, not their total assets. One of the reasons credit unions are bumping against the PCA one-size-fits-all target is because it is based upon total assets rather than risk assets. In a risk-based safety and soundness structure, risk-based assets should be the denominator.

Mr. SHERMAN. That would be more sophisticated. We now have low-income credit unions accepting supplemental capital.

Mr. DOLLAR. That is correct.

Mr. SHERMAN. I am not aware of any of the low-income credit unions getting together and passing around the same million dollars, although it would be good to plug that theoretical loophole. Have you discovered any problems with supplemental capital usage by the low-income credit unions?

Mr. DOLLAR. Frankly, there are many low-income credit unions, Congressman, that without supplemental capital would not be in operation today. It is essential for the establishment of the net worth that they need. However, at this stage, as you know, it is limited only to low income credit unions. But, there have not been any problems——

Mr. SHERMAN. So, it has been priory positive, then you are not aware of any negatives?

Mr. DOLLAR. There have not been any negatives that have not been manageable, Congressman.

Mr. SHERMAN. Another approach to this would be lowering by 1 percent the required capital, make it more equivalent to other depository institutions. What is your view on that?

Mr. DOLLAR. Well, there is no doubt that the credit union prompt corrective action, one-size-fits-all number is 1 percent higher than the other financial institutions. I personally think, rather than lowering that number, that, again, a better answer would be to calculate that percentage with a denominator of risk-based assets rather than total assets, then you would have many credit unions that would not fall into potential non-compliance.

Mr. SHERMAN. Now, with risk-based asset structure, is there subjective decisions that would have to be made by your auditors and, or, is it simply well you are in the category of credit cards, your category of this kind of this kind of asset, credit card or auto loan or home loan. Is it just put it in the right box or is it evaluated loan by loan?

Mr. DOLLAR. It would have to be done through regulation. And if you did authorize the prompt corrective action percentages for net worth to be calculated on risk-based assets, then we would have to come forward as a board and set that regulatory policy. But, everyone must understand that 7 percent capital in a credit union that has all U.S. Treasury securities is different than the one

that has 30-year fixed rate mortgages. There is a difference in the risk portfolio in individual institutions. We would have to, by regulation, draft a proposal that weighted those risk factors. But, this has been done previously. It was the way that we did prior to 1998 by statute and it can be done again.

Mr. SHERMAN. So, you do have the staff resources to make and audit these more sophisticated decisions?

Mr. DOLLAR. Indeed and to address it from what is our first priority of safety and soundness.

Mr. SHERMAN. I wonder if Ms. Lattimore could comment on this as well?

Ms. LATTIMORE. Yes, sir, I would be happy to on several issues. We have a lot of low-income credit unions in North Carolina. We probably have 20 CDCUS. I would say that probably all but one of them uses supplemental capital. It does not make good business sense to me to have a low income credit union have that ability, but not a healthy credit union, particularly when you are all in the same PCA box. The standards are not different for those when you put them in PCA. But, your suggestion of lowering from 7 percent, if you lowered it by 1 percent that would match the other financial institutions. That would only help in the percentage, it would not assist in anyway in the retained earnings being the only way to achieve net worth.

Mr. SHERMAN. And, that was not so much a suggestion as a question. I would like to see credit unions with more capital, with more cushion and able—as far as I am concerned, since I know whose the taxpayers behind is ultimately behind all of this, my constituents would like as many different cushions of as many different sizes, shapes and colors as possible. And the fact that all credit unions do not have this cushion simply exposes taxpayers to more risk then they would face otherwise.

I have concluded my questions.

Chairman BACHUS. Thank you.

General Counsel Kroener, we are attempting in Section Section 615 to address misrepresentations of FDIC deposit insurance coverage. And I know that you we are going to work with you on finetuning that section. But, would you briefly describe such misrepresentations, what they are today in the market? Also, what is the extent of your current enforcement abilities, first of all and then I will ask a follow-up on——

Mr. KROENER. Right. Let me start with the efforts we undertake. We do it just through monitoring market developments and through people reporting to us. We do become aware, in the course of our normal supervisory and regulatory activities of instances where institutions, that are, in fact, not insured banks, may be misrepresenting, particularly on the Internet—and this is a particularly recent development—that their products, in one way or another are insured products. Under existing law we refer those instances to appropriate U.S. Attorneys. In general we are talking about a violation of a criminal law here. We are not a criminal enforcement agency.

Frequently these may be involved in jurisdictions that are outside the United States where we do not have the right kind of subpoena power. That describes the legal picture. As a practical mat-

ter, where we can find out who it is, we will contact them and seek to get them to discontinue the activity. And, in some instances then, in fact, in most instances where we can find out where it is coming from, which is not always the case, we have been successful in having that activity discontinued. As a legal matter, as I say, what we do is refer it to U.S. Attorneys and they may, depending upon how serious it is and what their priorities may be, they may or may not take action.

Section 615, as it was proposed, I think is going to require a great deal of work with your staff because there is a mismatch. Right now our jurisdiction is over banks, not persons. The standard that is brought in there is a criminal standard of beyond a reasonable doubt, which is one we do not normally deal with. And, it may be difficult to get to something at the end of the day that we can really get comfortable with. It is worth the effort. I should add that on the pure misrepresentation side it is an area that falls into the FTC jurisdiction right now I believe.

But, we are prepared to try to work with the staff to see where we can get on this.

Chairman BACHUS. Sure.

Mr. KROENER. Or there might be other ways to approach the problem. As I say, just the straight going back and trying to discourage it has been, I think, reasonably successful in instances where you are not dealing with a remote jurisdiction that we cannot get to.

Chairman BACHUS. Okay. The section before that, Section 614, concerns your enforcement actions against independent contractors like accountants.

Mr. KROENER. Right.

Chairman BACHUS. What problems have you encountered with independent contractors and how will this provision make your job easier? And it is my understanding that you are comfortable with Section 614?

Mr. KROENER. Right. Yes, we are. Deputy Comptroller Williams, in fact, mentioned that in her oral statement, it is something that affects all the agencies. And, as she said, we have enforcement authority against a wide range of parties. But, for independent contractors, unlike all other parties, the standard is higher. It is a knowing and reckless standard and where, for example, you are dealing with accountants, there has been a concern and a reluctance to bring enforcement actions because of the facts of the higher standard. We have had some situations involving accountants, particularly in recent bank failures, where I think there has been some reluctance to bring enforcement actions because of this higher standard. And the section is intended to address that concern for all of the agencies, not just the FDICC.

Chairman BACHUS. Chief Counsel Williams, anything you would like to add? Not suggesting that you do.

Ms. WILLIAMS. No. I agree completely with what Bill just said.

Chairman BACHUS. Sure. Okay.

And, I think my question will be for you, but it is on Section 101. That expands the eligibility of community banks for treatment as Subchapter S corporations. In addition to Section 101 we have got Section 110, which makes it easier for community banks with na-

tional bank charters to qualify for certain favorable tax treatment as limited liability companies. Now, both those, I believe, were suggested by the OCC. And, would you explain why you made those requests and that we include them in the present legislation, which we have now? I know easing the tax burden on community banks is commendable and I am sure that is part of it, so they can devote more of their resources to lending to the community. But, I would like your further response.

Ms. WILLIAMS. I could not really say it too much better than that, Mr. Chairman. Both sections address issues that arise out of relatively old provisions in the National Bank Act that are not completely in sync with some of the flexibilities that are available today under modern corporate forms or, with respect to Section 101, the qualifying shares requirement, the fact that you can reflect the director's interest in the institution in ways other than the typical stock in the institution. And, so, the changes are designed to modernize the law. The burden relief, I think, will be primarily felt by community national banks. And, we are very comfortable that there are not any negative safety and soundness implications with these changes.

Chairman BACHUS. Thank you. Okay.

My last question is for Governor Olson. Section 501 amends some cross marketing restrictions that were imposed by Gramm-Leach-Bliley. How would this change current law and practice and will it expand the ability of financial holding companies or their subsidiaries or affiliates to engage in otherwise prohibited commercial activities? Will it expand their merchant banking authority?

Mr. OLSON. To the last two questions, no. But, let me address your question in reverse order. It does not expand the merchant banking authority. But, there are different provision's within the merchant banking section for an insurance company as opposed to a bank. There is an exception that is now provided for insurance companies that hold stock in companies in their merchant banking portfolio. It is a very limited exception involving statement stuffers and use of the Internet. What we are suggesting is that same provision ought to be allowed for banks. But, it does not, beyond that, broaden in any way the cross marketing provisions and it does not limit in any way the anti-tying provisions either.

Chairman BACHUS. So, it tries to eliminate a competitive disadvantage that you might have——

Mr. OLSON. That is correct.

Chairman BACHUS. ——with anti——

Mr. OLSON. And our recommendation includes one more change where the bank, in its merchant banking portfolio does not have a controlling interest, it eliminates the prohibition of cross marketing where control is not at issue.

Chairman BACHUS. So, it gives parity between——

Mr. OLSON. That is true.

Chairman BACHUS. Okay.

Mr. Sanders?

Mr. SANDERS. Thank you, Mr. Chairman. Again, my apology to you and the panel. I just have to be at another hearing.

Chairman BACHUS. And, let me say in the defense of all the members, we have briefings this morning again on Iraq. As I am

sure to most of you all, some of the reports are very disturbing about Iraqi soldiers basically violating the Geneva Convention in all sorts of ways using civilians as human shields, dressing in coalition uniforms, offering to a surrender and then executing ambushes. And, apparently, some of the latest activity is setting up and firing from schools with children there. So, that obviously is a distraction from this hearing.

Mr. Sanders?

Mr. SANDERS. Thank you, Mr. Chairman.

A couple of issues that I would like to pursue, the first issue, going back to my opening statement is that in recent years, as all of you will concur with, I think, and if you do not, please tell me, there are fewer, as a result of a lot of mergers, there are fewer and fewer banks and they are, in many instances, larger and larger. The phenomenon of too big to fail is something that interests me very much because I think it has huge potential danger for the taxpayers of this country. If a decision is made that a bank is about to fail and it is the economic implications of that are such that it would be a huge disaster for the economy, then what people here in Congress would say, well, we are not happy about it, but we have to bail it out because it will be less painful, less onerous to bail them out then allow them to fail.

But, you have that potential when you have banks that reach huge size.

So, Mr. Olson, if I may start off when you and anyone else who wants to pipe in on this, please do. In your judgment, how many banks do we have in this country that, in fact, are too big to fail? Is Citigroup too big to fail? Is Bank of America too big to fail? Is JP Morgan Chase too big to fail?

Mr. OLSON. Zero. There are no banks in this country that are too big to fail. You are on a subject that I feel very strongly about and I have looked at very carefully. I began most of my banking career as a community banker, although I did work for a large banking organization. During the deliberations on FDICCIA, during which the Congress directed the regulators as to what our responsibilities are with respect to that issue, I do not see how any regulator could read the provisions of FDICCIA and have any feeling that there is any ambiguity in the directive that has been given to us by the Congress with respect to too big to fail.

There is a provision in the FDICCIA legislation that would require a process that would go all the way to the president if we were to pursue it. But, I would say to you that one of the reasons that we have continuous supervision of our largest banking organizations is that we do not believe there should be and do not believe that there is a too big to fail policy.

Mr. SANDERS. Let me just—I am glad to hear that. I am not sure that I agree with you.

Mr. OLSON. Well, can I——

Mr. SANDERS. Let me just ask you this——

Mr. OLSON. Okay.

Mr. SANDERS. Several years before the S&L fiasco, which costs us what, several hundred billion dollars, the taxpayers?

Mr. OLSON. It is a large number, you are right.

Mr. SANDERS. Okay. Might it not have been possible that somebody sitting over your chair would have said the same thing in response to a question from up here? Now, for example, we can all understand that this is a very unstable international economy. I do not think there is any doubt about that. You have got war. You have got terrorism. You got all kinds of strange economic things happening all over the world. Now, what happens if a bank like Citigroup, which has huge foreign investments, suddenly started losing their shirt? What you are telling the chairman and myself, now that you have not the slightest doubt that Citigroup, you know, the airlines are running in here for their welfare payments right now. But, you are absolutely assured that CitiGroup and JP Morgan will never come in here and say, look, if you do not bail us out these are the ramifications. And, you better bail us out because it will be worse if you do not.

Mr. OLSON. I cannot tell you what they will do. But, what I can tell you is what we will do. Because you have given us a very specific directive in the prompt corrective action that we do not have in this policy is too big to fail. We do not have in this country a too big to fail policy. I do not see how you can read the prompt corrective actions provisions and have any other—if you are a regulator, and have a sense that we have any other policy at work in this country.

Mr. SANDERS. But let me, in English, for the three people that might be watching this on closed circuit television, what you are saying, and I am not sure that I agree with you, is that the chairman and I need not worry that there will be a hearing at some day lined up with all of the big banking executives begging for their welfare payments and telling us what will happen if the taxpayers do not bail them out? You are absolutely assuring us that they will never come?

Mr. OLSON. Well, now you have just changed the question.

Mr. SANDERS. Not really.

Mr. OLSON. Because what you have asked me now is will the chairman hold a hearing where the banks will be invited——

Mr. SANDERS. Well, no, let's not play with words.

Mr. OLSON. Okay.

Mr. SANDERS. You know what I mean. Are the taxpayers going to be held liable for these huge mergers, which have enormous potential dangers?

Mr. OLSON. I can say to you with absolute full confidence that we do not have a too big to fail policy with respect to large banks.

Mr. SANDERS. But, you are not answering my question. You may not have that policy. Now, you are acting like a lawyer here. Are you a lawyer, sir?

Mr. OLSON. By the grace of God I am not burdened with a law degree.

Mr. SANDERS. All right, then do not sound like one. All right. You are telling me—I am asking you about the danger——

Mr. OLSON. Yes.

Mr. SANDERS. Are you telling me, in your judgment, there is no danger that taxpayers in this country will be held liable when banks become so big that if they fail the economic implications are so huge that it makes sense for the government to bail them out?

Mr. OLSON. The reason I think there is—I cannot tell you with that sort of specificity. And the reason I cannot is there is a provision in the bill that does allow for a too big to fail. But, that is only—that would involve all the regulators, it would involve the Secretary of Treasury and it would involve the President of the United States. And I believe that the reasons that that provision is in the bill and it would require that sort of complexity is because the direction that the Congress has given to the regulators is not to have a too big to fail policy.

Now, I think there is a difference between today and the time to which you referred to the thrift industry problems of the early 1980s. My association with this issue goes back to the early 1980s with Continental Illinois. There is an all-together different regulatory environment, post FIRREA and FDICCIA. And, so, I think we have been given very specific instruction. And I share your concern. And I applaud you for brining it up.

Mr. SANDERS. You share my concern. Boy, that sort of popped up. I thought you did not share my concern. Do you share my concerns or do you not share my concerns.

Mr. OLSON. No, our concerns are the same——

Chairman BACHUS. He said that he had concerns, but not—I think what he was saying is he feels those institutions are sound at this time.

Mr. SANDERS. Well, I am not arguing that. But, we are worrying about in an unstable, as you know, Mr. Chairman, it is a very volatile world out there. I assure you the airline industry five years ago probably felt pretty good too.

All right. Let me go on to another.

Mr. KROENER. Mr. Sanders, if I could please?

Mr. SANDERS. Yes, please.

Mr. KROENER. Bill Kroener from the FDICC. First of all, let me say that I agree with everything that Governor Olson has said on this subject. I just wanted to add that to the extent there is a macro concern about going through resources in the insurance fund and ultimately reaching the taxpayers, one of the ways that that can be mitigated and this Congress can mitigate that, is with the deposit insurance reform proposal that I guess is going to the floor next week we now understand, because it would merge the funds and give us more flexibility to deal with your concerns. And I would call that to your attention and suggest that that is one way of responding to the concerns.

Mr. SANDERS. I understand that. But, you will, perhaps, disagree with me or not, but in the event of a real financial calamity there may not be enough money in those funds to do what has to be done and there be a necessity of going to taxpayers. Is that true or not?

Mr. KROENER. I agree with the prior discussion with Governor Olson that you had—yes.

Mr. SANDERS. Let me change subjects, if I might, Mr. Chairman.

Chairman BACHUS. And I would remind—you know, this hearing is not on FDICCIA. It is on a limited bill——

Mr. SANDERS. No, I do understand that.

Chairman BACHUS. ——on reg relief, so it really is not the subject matter of this hearing. But, it is a concern.

Mr. SANDERS. And it touches in the sense that we——

Chairman BACHUS. ——and I know you are addressing it.

Mr. SANDERS. Because it——

Chairman BACHUS. This legislation is not——

Mr. SANDERS. No, I know. It is not 100 percent——

Chairman BACHUS. Except in that it will—and I think that it has such broad bipartisan support it will relieve some unnecessary regulatory burdens, which will strengthen all our institutions and be good for our economy.

Mr. SANDERS. If I might, Mr. Chairman, because, again, going back to the implications of mergers and I think too big to fail is one. Let me touch on another one that concerns me. And, I do not know about you, Mr. Chairman, but I hear from constituents fairly often on this, and that is the issue of banking fees. When people have an account at a bank. My question is, let me start off with the easy one. I am assuming people disagree with me if you might, if you want, my assumption is that bank fees have gone up in the last five to 10 years. Does anyone disagree with that?

As they say for the record, Mr. Chairman, I do not see anyone jumping up and down and saying they disagree with this. I am taking that as a yes.

In terms of bank consolidation why should the average person, who is paying more for bank fees? And, in some instances really getting ripped off, if I might say so. Why would they want to see banks become larger, less competition and be forced to pay more in fees? Why is that a good thing Ms. Williams?

Ms. WILLIAMS. Congressman, I think that what you are raising is a very complicated issue. What we have seen evolving in the banking industry over the period of time that you are describing is more large institutions, but also many very healthy and competitive community-based institutions. And, in fact, in many situations in many markets, what we have seen is that consolidation has actually created opportunities for new banks to be chartered and for banks that have a more local orientation, a more specialized orientation to operate. So, I think that customers of financial institutions today have more choices. There may be certain institutions that have had fees that have been increased, but there are other institutions that compete very effectively by promoting the fact that they have lower fees then their competitors.

Mr. SANDERS. Well, I am sure that in some parts of the country what you are saying is exactly true. But, would you not deny that with fewer numbers of banks that, in fact, in many communities, the majority of communities, there is less competition, not more. I am not going to say that is true in every instance, and that the result of that has been or at least one of the results of that has been higher fees for the average person?

Ms. WILLIAMS. I am not in a position to say that that is across the board the case.

Mr. SANDERS. Well, I am not saying it is across the board. But, I am saying in many instances——

Ms. WILLIAMS. I think the other thing to introduce here is that with the increased use of technology in the provision of financial services, individuals that are located in particular communities can do their banking very effectively with an out-of-market institution that offers them the best price. So, the mix here, I think is more

complicated than just that consolidation means higher fees across the board.

Chairman BACHUS. Mr. Sanders, actually we have run about seven minutes over, but I am going to allow——

Mr. SANDERS. I am sorry.

Chairman BACHUS. ——you one other question.

Mr. SANDERS. Okay. Thanks. Thank you, Mr. Chairman.

A question for anybody who might know something about the issue, I represent a lot of workers who are concerned about various aspects of the economy. In your judgment, would somebody want to comment, how has—my impression is that mergers in many ways are resulted in fewer number of employees, layoffs and in some instances cut backs in pension benefits. Have mergers—my impression is that mergers have not been a positive thing for workers in the banking industry. Will somebody comment on that? Am I right or am I wrong?

Mr. OLSON. Congressman, I cannot speak to the pension benefits issue, because I do not have that information in front of me. But, there has been a reduction in the numbers of people employed in the banking industry. And, in part, I think it is because of the fact the banking industry is a mature industry. It is an industry that has not had the opportunity to grow laterally like a number of other industries have. And, as a result, as the banks have become increasingly efficient, largely through the opportunities available through technology, there has been a reduction in the numbers of jobs in the industry.

Mr. SANDERS. So, the growth, mergers, technology has resulted in fewer employees?

Mr. OLSON. I could not break it down specifically as to the extent to which it has been merger related. But, certainly there is a great deal for efficiency, much of which is a result of the—well, it is a result of a number of things. It is the desire to become increasingly efficient——

Mr. SANDERS. You are looking at it from the bank——

Mr. OLSON. ——and the opportunities of technology.

Mr. SANDERS. ——when you use the word efficiency, I use the word layoffs and workers who have lost decent jobs. And I understand where you are coming from. But, do not always look at it from one said.

Mr. OLSON. Okay.

Mr. SANDERS. Look at it from the worker who had a job for 20 years, no longer has a job. Okay.

Okay, Mr. Chairman, thank you very much.

Chairman BACHUS. This will conclude the hearing. I do want to make one general response to Mr. Sanders, just something for us all to think about. Twenty years ago if I wanted to bank I had to do it between the hours of 9:00 and 5:00. And I normally had to go anywhere from five to 15 miles to do it. Now, most of the transactions I want to do I can do within two blocks of where I am or four blocks from where I am. There are underserved areas. But, I can go to an ATM machine and quickly conduct my business and I pay a fee that did not exist 20 years ago, but certainly it saves me a lot of time and effort. So, in that regard, technology has certainly opened up our opportunity and the locations for banking.

One thing that Mr. Dollar has said, and I would agree with him, is that we all go into certain communities where we see loan title shops, we see payday lenders, we see check cashers, we see pawn shops. And we are trying to find ways to give those people alternatives through both the provision in the FDICC for people with low income to have basically check free services, and some to reduce their fees, and also to allow our institutions to meet some of those that are underserved. In that area, I would agree that we have more work to be done. But, I think the way to eliminate payday lenders, is to offer an alternative to those people.

Thank you.

I appreciate the professional manner in which you all have responded to questions and given your testimony. And I ask unanimous consent to enter into the record statements that the subcommittee regards concerning this hearing. If there no other business before the committee, the committee is adjourned and the panel is discharged.

[Whereupon, at 12:21 p.m., the subcommittee was adjourned.]

A P P E N D I X

March 27, 2003

**OPENING STATEMENT OF
CHAIRMAN SPENCER BACHUS
HEARING OF FINANCIAL INSTITUTIONS AND CONSUMER CREDIT
SUBCOMMITTEE ON THE FINANCIAL SERVICES REGULATORY RELIEF ACT
MARCH 27, 2003**

The Subcommittee meets today for a legislative hearing on H.R. 1375, the Financial Services Regulatory Relief Act of 2003, a bill introduced last week by our colleagues on the Subcommittee, Mrs. Capito of West Virginia and Mr. Ross of Arkansas.

H.R. 1375 is similar to regulatory relief legislation, H.R. 3951, which was approved last year by the Financial Institutions Subcommittee and the Financial Services Committee after two hearings in this subcommittee. That legislation was largely a product of recommendations that the Committee received from the Federal and State financial regulators in response to a request for regulatory relief recommendations from Chairman Oxley.

Earlier this year, the Chairman again requested that the financial regulators recommend regulatory relief proposals. H.R. 1375 is essentially last year's bill with the addition of various uncontroversial provisions recommended by regulators.

The banking industry estimates that it spends somewhere in the neighborhood of $25 billion annually to comply with regulatory requirements imposed at the Federal and State levels. A large portion of that regulatory burden is justified by the need to ensure the safety and soundness of our banking institutions; enforce compliance with various consumer protection statutes; and combat money laundering and other financial crimes.

However, not all regulatory mandates that emanate from Washington, D.C. or other state capitals across the country are created equal. Some are overly burdensome, unnecessarily costly, or largely duplicative of other legal requirements. Where examples of such regulatory overkill can be identified, Congress should act to eliminate them.

The bill that Congresswoman Capito and Congressman Ross have introduced – and that I am proud to cosponsor along with Chairman Oxley – contains a broad range of constructive provisions that, taken as a whole, will allow banks and other depository institutions to devote more resources to the business of lending to consumers and less to the bureaucratic maze of compliance with outdated and unneeded regulations. Reducing the regulatory burden on financial institutions lowers the cost of credit and will help our economy as it strives to emerge from recession.

In closing, let me once again commend Mrs. Capito and Mr. Ross for this important legislative initiative as well as the full Committee Chairman, Mr. Oxley, who is an original cosponsor of this legislation. The Chairman has demonstrated a strong commitment to getting regulatory relief legislation enacted this year. I also want to thank the financial regulatory agencies represented on our panel for their very helpful input and technical assistance in the drafting process.

I am now pleased to recognize the Ranking Member, Mr. Sanders, for an opening statement.

March 27, 2003

Opening Statement by Congressman Paul E. Gillmor
House Financial Services Committee
Subcommittee on Financial Institutions and Consumer Credit
Hearing on HR 1375, the Financial Services Regulatory Relief Act of 2003

Thank you, Mr. Chairman, for calling this hearing to discuss HR 1375, the Financial Services Regulatory Relief Act of 2003. I am very interested to hear the opinions of the respective agencies represented this morning.

The issue of regulatory reform is very important to the financial services industry and quite familiar to this committee. We considered and approved a similar bill, HR 3951, to this one in the 107th Congress. However, as the Senate failed to act on the issue we must continue the debate.

Last year, this committee heard testimony and received extensive input from both regulators and industry representatives on HR 3951. As we continue such discussions this morning, I am confident they will produce sound legislation that appropriately addresses the needs of modern banks, savings associations, credit unions and federal regulatory agencies, while preserving the overall legislative intent of the affected regulations.

I trust this committee will move swiftly in our further deliberations and deliver this important modernizing legislation to the full House of Representatives without delay.

Again, I thank Chairman Bachus for holding today's hearing and look forward to an informative session.

OPENING REMARKS OF THE HONORABLE RUBÉN HINOJOSA ON H.R. 1375, "FINANCIAL SERVICES REGULATORY RELIEF ACT OF 2003" HOUSE FINANCIAL SERVICES COMMITTEE SUBCOMMITTEE ON FINANCIAL INSTITUTIONS MARCH 27, 2003

Chairman Bachus and Ranking Member Sanders,

I want to thank you for holding this important hearing on H.R. 1375, the "Financial Services Regulatory Relief Act of 2003," legislation that is almost identical to the regulatory relief bill we considered last year, with a few additions.

I look forward to hearing from the regulators you have arranged to testify here today.

In particular, I look forward to learning their recommendations for ways to relieve financial institutions from regulatory impediments that prevent them from providing our communities with funds needed for economic growth.

I represent a South Texas Congressional District that has been plagued by a chronically high unemployment rate, which remains above 10 percent. While I have been able to reduce the undemployment rate in my District by working with the economic development councils, mayors, financial institutions and small business entrepreneurs, obstructions remain that inhibit further reductions of this unemployment rate.

Hopefully, the regulators before us have taken into account the impact their regulatory relief recommendations will have on economic development. Furthermore, I hope that they have made proposals that will treat all the financial institutions equitably and create a level playing field so that we can avoid turf battles.

I would like to know if somewhere in this rather long, intricate legislation there is a provision that enables community banks to compete with their larger colleagues.

Mr. Chairman, I have several other questions I would like to ask and issues that I would like to address, but I will leave them for the Question and Answer period.

I look forward to hearing the testimony, and I look forward to working with my colleagues on this legislation as it works its way through this Committee.

Thank you. I ask that my full statement be included in the record.

Opening Statement
Congressman Ed Royce (CA-40)
27 March 2003
Regulatory Relief Hearing

Mr. Chairman, thank you for holding this hearing to address the issue of regulatory relief for the financial services industry, a measure that I believe is constructive, well-reasoned and long overdue. For far too long, Congress has burdened our country's federally-chartered banks, thrifts and credit unions with well-intentioned but onerous and often outdated rules and regulations, preventing them from operating as efficiently and competing as effectively as they should. I commend the Chairman and Rep. Capito for their leadership and persistence on this matter, and once again I would like to voice my strong support for their efforts to reduce the red-tape associated with regulating these financial institutions, thereby increasing the efficiency of the entire American financial services industry.

Additionally, I would also like to take this opportunity to reiterate my strong support for section (306) of this bill that incorporates my legislation, H.R. 383, the "Faith-Based Lending Protection Act," which has a broad base of support among 20 of my colleagues from both sides of the aisle. This legislation amends the Federal Credit Union Membership Act to exclude loans made to nonprofit religious organizations from the maximum amount of member business loans outstanding at a federal credit union at any one time.

As the law is currently written, loans made by federal credit unions to non-profit religious organizations are included in these credit unions' statutory member business loan limit, which totals 12.25% of the credit union's total assets. However, the law already provides an exemption from this member business loan cap for credit unions that have a history of primarily making these types of loans. My provision represents the correction of an oversight made during the Credit Union Membership Act of 1998, in that it simply extends the ability to make these types of loans exempt from the business-loan cap to all credit unions, not just those with a history of primarily doing so.

In his prepared remarks today, Chairman Dollar of the National Credit Union Administration (NCUA) stated that the NCUA has "no safety and soundness concerns whatsoever" with the Faith-Based Lending provision. Furthermore, in testimony before this Subcommittee in March 2002, Chairman Dollar asserted that the "delinquency rates on all member business lending in credit unions is lower than the delinquency rates on personal loans," and that faith-based institutions enjoy the lowest delinquency rates among this category of loans, making these loans to nonprofit religious organizations the "safest of the safest" loans around.

While Congress is debating the issue of providing regulatory relief to the financial services industry, I believe that it is important to recognize this statutory oversight that adversely affects small faith-based initiatives in our communities. By enacting this provision, Congress can help to ensure that the lending needs of these small non-profit organizations – who are too often ignored by larger banks and thrifts because of their slim profitability – are met.

I would like to thank the gentlemen for the opportunity to speak on behalf of my legislation and on behalf of the efficiency improvements made throughout the entire regulatory relief bill.

STATEMENT BY REP. BERNIE SANDERS ON H.R. 1375, THE FINANCIAL SERVICES REGULATORY RELIEF ACT OF 2003

I would like to thank Chairman Bachus for holding this important hearing.

Among other things, the Financial Services Regulatory Relief Act would make it easier for some of the biggest banks and other financial institutions in this country to merge. Specifically, the bill would reduce the federal review process for bank mergers from 30 days to a mere five days. The bill would allow the Office of Comptroller Currency to waive notice requirements for national bank mergers located within the same state. The bill would end the prohibition of out-of-state banks merging with in-state banks that have been in existence for less than 5 years. The bill also gives federal thrifts the ability to merge with one or more of their non-thrift affiliates. Finally, the bill would eliminate certain reporting requirements for bank CEOs in regards to inside lending activities.

Mr. Chairman, I have serious concerns regarding these provisions in the bill.

During the past 22 years, the banking industry has experienced unprecedented merger activity. From 1980 to 2002, there were over 9,500 banking mergers, with total acquired assets of more than $2.4 trillion.

During the 1990s, many of these mergers involved large banks. Some of the proposed mergers had the potential for serious anti-competitive effects in local markets. Yet, during this period, hardly any mergers were denied based on competitive grounds.

As a result of merger mania, there has been a substantial decline in the number of commercial banking organizations in the U.S. We have gone from 12,741 commercial banks in 1989 to 7,903 in 2002.

In 1998, several of the largest bank mergers in history took place. For example, Nations Bank merged with Bank of America resulting in the third largest banking organization with approximately $580 billion in assets. In addition, Norwest merged with Wells Fargo and Bank One merged with First Chicago. Finally, Travelers Group and Citicorp merged and formed the largest banking organization in the United States.

The 25 largest banks in this country now account for more than half of all of the total deposits in this country.

It is my understanding that the Federal Reserve Board and the Office of Comptroller Currency have published descriptive material on fewer and fewer of their merger decisions. I would like to hear from our witnesses as to why this is the case?

I am very concerned that as a result of these mergers, an increasing number of banks are considered to be too big to fail. In other words, these banks are now so big that if they should get into trouble, the American taxpayer will have to bail them out. I would like to find out from our witnesses today, how many banks they consider to be too big to fail, and what type of action would they take if these institutions were to fail.

Mr. Chairman, has merger mania led to a reduction in bank fees for the American consumer? The answer is a clear and resounding no. American

consumers are facing a real crisis in banking services. More than 12 million American families cannot afford bank accounts, and those who can afford them are paying too much -- especially if they bank at big banks.

Since bank deregulation began in the early 1980's, consumer groups such as U.S. PIRG have documented skyrocketing consumer banking fees. Bank fees are rising dramatically, and the fees charged by big banks are rising the fastest of all.

The average annual cost to a consumer of maintaining a regular checking account rose to more than $200 over the past few years -- an increase of $17 compared to 1997. Consumers who bank at big banks paid more than $220 a year for the privilege of maintaining a regular checking account -- 16% more than small bank consumers and 110% more than credit union members.

Not only are these mergers bad for consumers, they are also bad for bank employees. According to an article that appeared in Newsday on November 28, 1999:

"Firms that shift to cash balance plans have often been corporations recently involved in **mergers** and acquisitions. And when two firms merge, as was the case of Citicorp and the Travelers Group Inc., **employees** of the company with a traditional pension - in this case Citicorp - are often forced into the cash-balance plan already in existence at the other firm."

According to the General Accounting Office, cash balance pension conversions can slash workers' pensions by as much as 50%. Should we be making it easier for banks to merge if these mergers have the effect of slashing the pensions of their workers?

Meanwhile, banks have been receiving over $70 billion in profits a year. And Congress continues to roll back critical banking laws that protect consumers, taxpayers and communities.

Mr. Chairman, during this time of merger mania that has led to decreased competition and higher fees for consumers, is it really prudent to make it even easier for these large financial institutions to become even larger? I think this question needs to be asked at this hearing and I look forward to hearing about this from our witnesses.

Embargoed
until March 27 at 10:00 am

Statement
of

Carolyn J. Buck, Chief Counsel
Office of Thrift Supervision

concerning

Reducing Regulatory Burden

before the

Subcommittee on Financial Institutions and Consumer Credit
U. S. House of Representatives

March 27, 2003

Office of Thrift Supervision
Department of the Treasury

1700 G Street N.W.
Washington, D.C. 20552
202-906-6288

Statement required by 12 U.S.C. 250:

The views expressed herein are those of the Office of Thrift Supervision and do not necessarily represent those of the President.

Testimony on Reducing Regulatory Burden
before the
Subcommittee on Financial Institutions and Consumer Credit
U. S. House of Representatives
March 27, 2003

Carolyn J. Buck, Chief Counsel
Office of Thrift Supervision

I. Introduction

Mr. Chairman, Ranking Member Sanders, and members of the Subcommittee, good morning and thank you for the opportunity to discuss the regulatory burden reduction initiatives currently being considered by the Subcommittee. We commend Congresswoman Capito for introducing H.R. 1375, the "Financial Services Regulatory Relief Act of 2003," and for her continuing efforts in support of regulatory burden relief. It is always important to remove unnecessary regulatory obstacles that hinder profitability, innovation, and competition in our financial services industry.

Relieving institutions from these burdens meshes well with three responsibilities that OTS Director James E. Gilleran has emphasized for OTS:

- Protecting taxpayers by minimizing risks to the insurance fund. Relief from superfluous regulatory burden enhances the safety and soundness of institutions by avoiding the distraction of complying with needless red tape.

- Keeping the financial institution system healthy. Reducing regulatory burden and enhancing supervision are both important in assuring the continued health of the financial services system.

- Protecting consumers by fully utilizing the consumer laws that we enforce.

II. Support for Other Pending Congressional Initiatives

The House is already hard at work on several fronts to provide regulatory relief.

A. Deposit Insurance Reform

We congratulate the Committee on reporting out H.R. 522, the "Federal Deposit Insurance Reform Act of 2003." Merger of the Bank Insurance Fund and the Savings Association Insurance Fund is a central feature of the bill. It is long past time to merge the funds, and there is no longer any controversy about this important reform. We strongly support merger because it will promote efficiency in administering the funds and, more importantly, result in a more stable insurance system. The bill also gives the Federal Deposit Insurance Corporation (FDIC) Board flexibility to set the designated reserve ratio within a target range and decide when to increase or decrease assessments to assure the continued stability of the insurance fund. This will assure a safer and more stable insurance system. Providing certainty about the process for determining the amount of deposit insurance assessments and eliminating the procyclicality of the current system—which imposes higher assessments when institutions are least able to afford them—are very important regulatory burden reduction initiatives.

B. Business Checking

We also congratulate the Committee on reporting out H.R. 785, the "Business Checking Freedom Act of 2003." OTS supports enactment of legislation to permit depository institutions to pay interest on business transaction accounts. We agree that the current limitations no longer serve a public purpose and are ineffective. The prohibition is circumvented daily by sweep accounts and similar vehicles. Permitting insured depositories to offer interest directly on demand deposit accounts will help smaller institutions compete with other financial providers, such as money market mutual funds, resulting in greater market and institutional efficiencies. For competitive and fairness reasons, it is time to modernize this provision.

III. Removing Disparate Treatment of Thrifts under the Federal Securities Laws (§ 201)

OTS is particularly pleased that H.R. 1375 would eliminate disparate treatment of thrifts under the federal securities laws. This reform is, by far, the most significant regulatory burden reduction provision for thrifts in the bill. The proposal removes the investment adviser and broker-dealer registration requirements that continue to apply to thrifts under the Investment Advisers Act (IAA) and the Securities Exchange Act of 1934. Despite the fact that banks and thrifts may engage in substantially similar activities, subject to substantially

similar supervision, thrifts do not enjoy the same exemption as banks from these securities laws.

Thrifts and banks provide investment adviser, trust and custody, third party brokerage, and other related services in the same manner and under equivalent statutory authority. OTS examines securities-related thrift activities the same way as the OCC and other banking agencies examine comparable bank activities. Notwithstanding bank-equivalent activities, authority, and supervision, thrifts have been subject to different requirements under the SEC's interpretation of the securities laws. There is no logical basis to structure the regulatory oversight of these activities differently for thrifts and banks. Removing the disparity will reduce regulatory burden by eliminating duplicative paperwork and providing cost savings for thrifts. It will also remove a disincentive for institutions to select the most appropriate charter.

Different purposes of the various banking charters make our financial services industry the most flexible and successful in the world, but disparities unrelated to those purposes only cause unnecessary costs for institutions and consumers. While OTS strongly supports each institution having a choice of charters, that decision should be based on which charter is the best fit for its business. The proposed amendments to the federal securities laws remove distinctions that have caused some depository institutions to make a charter choice to avoid SEC regulation and reduce costs, even though the thrift charter is otherwise a better fit for their businesses.

The details of the current situation are complex, but I will briefly summarize the key points.

Banks—but not thrifts—enjoyed a blanket exemption from broker-dealer registration requirements under the Securities Exchange Act before changes made by the Gramm-Leach-Bliley Act (GLB Act). The GLB Act removed the blanket exemption and permitted banks to engage only in specified activities without having to register as a broker-dealer. All other broker-dealer activities must be "pushed out" to a registered broker-dealer. The SEC issued interim broker-dealer rules on May 11, 2001, to implement the new "push-out" requirements, and on October 30, 2002, published proposed amendments to the interim dealer rule. As part of the broker-dealer "push out" rules, the SEC exercised its authority to include thrifts within the bank exemption. This gave thrifts parity with banks for the first time for purposes of broker-dealer

registration.[1] In the broker-dealer changes, the SEC recognized it would be wrong to continue disparate, anomalous treatment between thrifts and banks.

The SEC postponed the effective dates of the interim rules several times. It published the final dealer rule on February 24, 2003, and it continues to develop the final broker rule. In the meantime, banks and thrifts both continue to have a blanket exemption from the definition of broker (the current extension expires May 12, 2003).

Under SEC interpretation, banks—but not thrifts—are exempt from investment adviser registration requirements under the IAA. In 1999, the GLB Act narrowed the bank exemption and now requires a bank to register when it advises a registered investment company, such as a mutual fund. The SEC division responsible for investment adviser registration has been reluctant to recommend to the Commission that it provide the same equal treatment of banks and thrifts as the SEC has already adopted for broker-dealers.

Detailed Explanation

Treating thrifts and banks the same under both the IAA and the Securities Exchange Act makes sense for the following reasons:

- The statutory authorities for thrifts and banks to engage in trust services are essentially the same. In 1980, Congress gave thrifts the authority to offer trust services closely based on parallel national bank authority. The Senate report for the Depository Institutions Deregulation and Monetary Control Act of 1980 explained that the Home Owners' Loan Act (HOLA) amendment gives thrifts "the ability to offer trust services on the same basis as national banks."[2] Consistent with this legislative history, these amendments further promote uniformity in the way thrifts and banks provide trust services.

- OTS examines securities-related thrift activities the same way as the OCC and the other banking agencies examine comparable bank activities, not only to assure safe and sound operations, but also to protect customers. OTS has formalized its policies with new regulations and guidance. On

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[1] The SEC rule does not, however, address other problems under the Securities Exchange Act, such as the need to exempt thrift collective trust funds from registration to the same extent as bank collective trust funds.

[2] S. Rep. No. 96-368, at 13 (1979), reprinted in 1980 U.S.C.C.A.N. 236, 248.

December 12, 2002, OTS issued a final rule establishing recordkeeping and confirmation requirements for thrifts that effect securities transactions. The rule assures that thrift customers receive the same protections and disclosures as bank customers; these protections and disclosures are equivalent to those that protect customers of broker-dealers and investment advisers registered with the SEC. In August 2001, OTS issued an entirely revised trust and asset management handbook that assists examiners in planning and conducting examinations of trust and asset management products and services to assure they are provided consistent with applicable law and customer protection requirements.

- To the extent thrifts are subject to different rules and must register with the SEC, they are placed at a competitive disadvantage to banks due to the additional paperwork and costs related to IAA registration. The cost to new and small institutions is particularly significant and can greatly affect profitability. The competitive disadvantage in dual compliance has caused some thrifts recently to convert to a bank or state trust company charter to obtain the benefit of the registration exemption under the Investment Advisers Act. This allows them to avoid SEC regulation with a one-time conversion cost. It is sound public policy to treat the bank and thrift charters the same where similarly situated. This promotes a level playing field among depository institutions in the marketplace.

- Some have objected to this change based on concerns that it would give thrifts a competitive advantage over registered investment advisers. The stronger argument supports comparable regulatory treatment of depository institutions that already have the same powers and that are subject to equivalent, frequent oversight by the appropriate federal banking agency. Most importantly, the amendment will have a relatively minor impact on the investment adviser industry because banks are already exempt and, if this proposal does not become law, the trend of thrifts to convert to a bank charter could intensify.

- OTS agrees with the SEC analysis set forth in its preamble to the May 2001 interim broker-dealer "push-out" rule. The logic of the SEC argument in the context of the broker-dealer rule applies equally for purposes of extending to thrifts the same investment adviser registration exemption that applies to banks. The SEC explained the basis for its decision to exempt thrifts from broker-dealer registration to the same extent as banks, as follows:

"Now that the general exception for banks has been replaced, and the differences between banks and savings associations have narrowed; it seems reasonable to afford savings associations and savings banks the same type of exemptions. Moreover, insured savings associations are subject to a similar regulatory structure and examination standards as banks. We find that extending the exemption for banks to savings associations and savings banks is necessary or appropriate in the public interest and is consistent with the protection of investors." 66 Fed. Reg. 27788 (May 18, 2001).

In an effort to resolve, administratively, the issue of how to extend the bank exemption to thrifts under the IAA, OTS has communicated with the SEC for a number of years. The SEC has, on occasion, expressed a commitment to achieve a mutually satisfactory resolution. We understand that in 2000 an amendment to a bill under consideration by a Senate committee was withdrawn after SEC staff informally advised that the issue of extending the IAA exemption to thrifts might be handled by regulation. However, the SEC has demonstrated no sense of urgency in resolving this matter. To avoid further delay, we urge Congress to act now to remove the disparity and to make the changes necessary to eliminate the numerous incidental differences that remain. Legislation would also have the beneficial effect of avoiding the need for a series of SEC administrative exemptions—another potential regulatory burden.

IV. Streamlining for Thrift Institutions—OTS Proposals

H.R. 1375 includes other important regulatory burden relief initiatives that OTS has proposed. We appreciate the opportunity to work with the Committee's staff on these provisions that will be of significant benefit to the thrift industry as a whole.

A. Modernizing Thrift Community Development Investment Authority (§ 202)

OTS supports updating HOLA to give thrifts the same authority as national banks and state member banks to make investments to promote the public welfare. This proposal enhances the ability of thrifts to contribute to the growth and stability of their communities.

Due to changes made to HUD's Community Development Block Grant (CDBG) program more than 20 years ago, thrift investment opportunities that

meet the technical requirements of the statute are rare. OTS has found it cumbersome to promote the spirit and intent of Congress's determination to allow thrifts to make such community development investments. Currently, using its administrative authority, OTS may issue a "no action" letter when a thrift seeks to make a community development investment that satisfies the intent of the existing provision, but does not clearly fall within the wording of the statute or the "safe harbor" criteria issued by OTS for these investments. The no-action process, however, takes time and lacks certainty.

The proposed amendment closely tracks the existing authority for banks. Under the amendment, thrifts may make investments primarily designed to promote the public welfare, directly or indirectly by investing in an entity primarily engaged in making public welfare investments. There is an aggregate limit on investments of 5 percent of a thrift's capital and surplus, or up to 10 percent on an exception basis.

B. Eliminating Geographic Limits on Thrift Service Companies (§ 503)

OTS strongly supports legislation authorizing federal thrifts to invest in service companies without regard to geographic restrictions. Current law permits a federal thrift to invest only in service companies chartered in the thrift's home state. HOLA imposed this geographic restriction before interstate branching and before technological advances such as Internet and telephone banking, and it no longer serves a useful purpose. This restriction needlessly complicates the ability of thrifts, which often operate in more than one state, to join together to obtain services at lower costs due to economies of scale.

Today, a thrift seeking to make investments through service companies must create an additional corporate layer—known as a second-tier service company—to invest in enterprises located outside the thrift's home state. Requiring the formation of second-tier service companies serves no rational business purpose, results in unnecessary expense and red tape for federal thrifts, and discourages otherwise worthwhile investments.

C. Authorizing Federal Thrifts to Merge and Consolidate with Their Non-thrift Affiliates (§ 203)

OTS favors giving federal thrifts the authority to merge with one or more of their non-thrift affiliates, equivalent to authority for national banks enacted at

the end of 2000.[3] The new authority does not affect the applicability of the Bank Merger Act or give thrifts the power to engage in new activities.

Under current law, a federal thrift may merge only with another depository institution. This proposal reduces regulatory burden on thrifts by permitting certain mergers, where appropriate for sound business reasons and if otherwise permitted by law. Today, if a thrift wants to acquire the business of a non-depository institution affiliate, it must engage in a series of transactions, such as merging the affiliate into a subsidiary and liquidating the subsidiary into the thrift. Structuring a transaction in this way can be costly. Under this amendment, thrifts may merge with affiliates and continue to have the authority to merge with other depository institutions, but may not merge with other kinds of entities.

D. Repealing the Statutory Dividend Notice Requirement for Thrifts in Savings and Loan Holding Companies (§ 204)

The proposed legislation repeals the requirement in section 10(f) of HOLA that any thrift owned by a savings and loan holding company must notify OTS 30 days before paying a dividend. Under the proposed amendment, the Director could continue to require prior notice, where appropriate, and establish reasonable conditions on the payment of dividends.

The current dividend notice requirement does not depend on a thrift's capital condition or relative risk to the insurance fund. No similar limitation on thrift owners applies to thrifts controlled by individuals, thrifts controlled by bank holding companies, or banks. There is no basis for disparate treatment based on the form of ownership of thrifts.

Federal statutes and regulations assure that thrifts held by holding companies may only pay dividends in appropriate circumstances, and this amendment confirms this authority. All thrifts are subject to the prompt corrective action—PCA—provisions that generally prohibit an insured depository institution from paying a dividend if doing so would make it undercapitalized. In addition, based on OTS's general regulatory authority, OTS has a capital distributions regulation[4] that governs when a thrift must file an application or give notice if it decides to pay a dividend. In 1999, as part of OTS's ongoing regulatory burden reduction effort, OTS amended its regulations to exempt

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[3] Section 6 of the National Bank Consolidation and Merger Act (12 U.S.C. 215a-3).

[4] 12 CFR Part 563, Subpart E.

adequately capitalized, highly rated thrifts from providing advance notice of dividends under certain circumstances. The rule conformed OTS's dividend requirement more closely to those of the other federal banking agencies. This proposal will permit OTS to extend to thrifts owned by savings and loan holding companies the same regulatory relief that is available to all other thrifts.

V. Streamlining for Thrift Institutions—Other Proposals

OTS would like to comment briefly on several other provisions of H.R. 1375.

A. Clarification of Citizenship of Federal Thrifts for Federal Court Jurisdiction (§ 213)

OTS supports the amendment to clarify citizenship of federal thrifts for purposes of determining federal court diversity jurisdiction. Not all courts agree that a federal thrift should be treated as a citizen only of its home state, consistent with the rule for national banks. The amendment would permit a thrift involved in an interstate dispute to remove the matter to federal court based on diversity jurisdiction. This change will establish a uniform rule governing federal jurisdiction when a thrift is involved and, accordingly, reduce confusion and uncertainty.

B. Removal of Qualified Thrift Lender Requirements with Respect to Out-of-State Branches of Federal Thrifts (§ 211)

OTS also supports removing the requirement that federal thrifts meet the QTL test on a state-by-state basis. This requirement is a superfluous regulatory burden because interstate thrifts may easily structure their activities to assure compliance with the state-by-state requirement. The QTL test would, of course, continue to apply to the institution as a whole.

VI. Streamlining for Depository Institutions

A. Enhancing Examination Flexibility (§ 601)

OTS strongly supports the proposal to give additional flexibility to permit the federal banking agencies to adjust the examination cycle for depository institutions. The Federal Deposit Insurance Act (FDIA) currently requires

annual examinations for all but the smallest institutions. Small institutions that have assets less than $250 million and are well-capitalized and well-managed may be examined every 18 months. A large majority of thrifts are well-run institutions that do not require full-fledged annual examinations to assure their safety and soundness. This is also true for the majority of banks. This amendment will reduce risk to the insurance fund by permitting the banking agencies to focus supervisory attention on the institutions that are, or are at the greatest risk of becoming, troubled.

B. Enhancing Authority to Enforce Agreements (§ 405)

OTS welcomes the amendment to clarify provisions of the FDIA that some courts have interpreted to limit the ability of banking agencies to require an institution-affiliated party (IAP) to transfer capital to an institution. In particular, the amendment clarifies that limits in sections 8(b)(6)(A)(i) and (ii) and section 38(e)(2)(E) of the FDIA do not apply when a federal banking agency seeks to enforce certain conditions imposed on, and agreements with, IAPs that pre-date the enforcement action. These amendments will enhance the safety and soundness of insured depository institutions and protect the insurance fund from unnecessary losses.

Neither of these two sections should apply when a banking agency seeks to require an IAP to meet its prior obligations. Agencies must be able to count on financial commitments an IAP made to support a depository institution in its application for a charter or in any other agreement. It is illogical to reduce or eliminate an IAP's prior commitment at the very time the institution most needs it. The sections in question make sense only in the context of an agency seeking to impose additional requirements to resolve problems at a troubled depository institution.

C. Streamlining Agency Action under the Bank Merger Act (§ 607 & § 609)

OTS supports streamlining Bank Merger Act application requirements by eliminating the requirement that each federal banking agency request a competitive factors report from the other three banking agencies and the Attorney General. This means five agencies must consider the competitive effects of every proposed bank or thrift merger. The vast majority of proposed mergers do not raise anti-competitive issues, and these multiple reports, even for those few that do raise issues, are not necessary. The amendment decreases the number to two, with the Attorney General continuing to be required to consider the competitive factors involved in each

merger transaction and the FDIC, as the insurer, receiving notice even where it is not the lead banking agency for the particular merger. This will streamline the review of merger applications while assuring appropriate consideration of all anti-competitive issues.

OTS also supports amending the Bank Merger Act to shorten the post-approval waiting period before a transaction subject to the Act may be consummated. After approval, except in the case of emergencies, mergers are subject to a 30-day waiting period to give the Attorney General time to initiate legal action where the Attorney General determines the merger would have a significantly adverse effect on competition. The lead banking agency and the Attorney General may agree to shorten the waiting period to 15 days. This proposal shortens the statutory minimum from 15 to five days. Permitting a merger to go forward sooner will reduce burden on the affected depository institutions.

VII. Agency Continuity: Creation of Statutory OTS Deputy Directors

OTS urges Congress to authorize the Treasury Secretary to appoint up to four Deputy Directors for OTS to assure agency continuity. This would remove any question about a Deputy Director's authority to perform the functions of the Director during a planned or sudden vacancy in the office of the Director or during the absence or disability of the Director. Especially at this time of national emergency, we should take every possible step to assure the stability of the financial system and the regulatory oversight agencies. For example, uncertainty about the authority of an acting OTS Director should not be allowed to impair our participation in the Financial and Banking Information Infrastructure Committee, the entity charged with coordinating federal and state financial regulatory efforts to improve the reliability and security of the U.S. financial system.

The new authority would be based closely on long-standing authority[5] for appointing Deputy Comptrollers in the Office of the Comptroller of the Currency (OCC). Consistent with the existing OCC legislation, the HOLA amendment would require the Treasury Secretary to make the OTS appointments so each Deputy Director would qualify as an "inferior officer" under the Appointments Clause of the Constitution.

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[5] 12 U.S.C. 4

The safety and soundness of the banking system depends on regular, uninterrupted oversight by the federal banking agencies. The reality of the appointments process is that there can be a delay of many months before a sub-cabinet level position is filled, and these delays have grown significantly over the last 20 years. An event resulting in numerous vacancies in the Executive Branch would, of course, exacerbate this problem. In light of these growing, and potentially even greater, delays, it is especially important to establish a statutory chain of command within OTS that will avoid the possibility of gaps in authority to regulate and supervise thrifts, eliminate uncertainty for the thrifts OTS regulates, and avoid future litigation over whether the acts of OTS staff are valid.

OTS is the only financial services sector regulator that could be readily exposed to this vacancy problem. During a vacancy, OTS succession now occurs through the process of the Vacancies Act, which does not ensure an immediate succession when the OTS Director departs and limits the period an acting Director may serve. The organic statutes of the other financial regulators minimize or avoid vacancy problems by providing for automatic and immediate succession or by vesting authority in the remaining members of a board or commission.

VIII. Conclusion

OTS is committed to reducing burden wherever it has the ability to do so consistent with safety and soundness and compliance with law. The proposed legislation advances this objective. We especially appreciate inclusion of the amendments to remove disparate treatment of thrifts under the federal securities laws. I want to thank you, Mr. Chairman, and the others who have shown leadership on this issue. We look forward to working with the Subcommittee to shape the best possible regulatory burden reduction legislation.

STATEMENT

OF

THE HONORABLE DENNIS DOLLAR
CHAIRMAN
NATIONAL CREDIT UNION ADMINISTRATION

ON THE
"FINANCIAL SERVICES REGULATORY RELIEF ACT OF 2003"
H.R. 1375

BEFORE THE

SUBCOMMITTEE
ON
FINANCIAL INSTITUTIONS AND CONSUMER CREDIT
U.S. HOUSE OF REPRESENTATIVES

MARCH 27, 2003

Chairman Bachus, Ranking Member Sanders and Members of the Subcommittee, thank you for providing me the opportunity to appear on this panel today on behalf of the National Credit Union Administration and to discuss our agency's views on H.R. 1375, the "Financial Services Regulatory Relief Act of 2003."

Chairman Oxley, Representative Capito and Representative Ross, thank you for your sponsorship and ongoing support of this worthy and necessary legislation.

During the 107th Congress the National Credit Union Administration (NCUA) appreciated the opportunity you extended to work in concert with you and the Committee on Financial Services to develop legislation previously entitled the "Financial Services Regulatory Relief Act of 2002," H.R. 3951. NCUA is pleased to again this year provide recommendations "to lessen the regulatory burden on insured depository institutions and improve productivity, as well as make needed technical corrections to statutes" in response to your most recent request of January 8, 2003. The National Credit Union Administration continues to believe this legislation will positively impact our ability to provide a safe and sound regulatory environment for America's credit unions in an ever-changing and dynamic financial marketplace.

On behalf of the NCUA Board, I am pleased to present the Committee with the same recommendations NCUA provided to you in August 2001, in no order of preference, that address regulatory relief and productivity improvements for federal credit unions (FCU's). These proposals are consistent with the mission of credit unions and the principles of safety and soundness. They address statutory restrictions that now act to frustrate the delivery of financial services because of technological advances, current public policy priorities, or market conditions.

Check Cashing, Wire Transfer and Other Money Transfer Services

The Federal Credit Union Act authorizes FCUs to provide check cashing and money transfer services to members (12 USC 1757(12)). To reach the "unbanked," FCUs should be authorized to provide these services to anyone eligible to become a member. This is particularly important to the overwhelming majority of FCUs whose field of membership includes individuals of limited income or means. These individuals in many instances do not have mainstream financial services available to them and are often forced to pay excessive fees for check cashing, wire transfer and other services. Allowing FCUs to provide these limited services to anyone in their field of membership would provide a lower-fee alternative for these individuals and encourage them to trust conventional financial organizations. NCUA is pleased to see this recommendation incorporated in Section 307 of the bill.

The Twelve-Year Maturity Limit on Loans

FCUs are authorized to make loans to members, to other credit unions and to credit union organizations. The Federal Credit Union Act imposes various restrictions on these authorities, including a twelve-year maturity limit that is subject to only limited exceptions (12 USC 175(5)). This "one-size-fits-all" maturity limit should be eliminated. It is outdated and unnecessarily restricts FCU lending authority. FCUs should be able to make loans for second homes, recreational vehicles and other purposes in accordance with conventional maturities that are commonly accepted in the market today. It is our view that NCUA should retain the rulemaking authority to establish any maturity limits necessary for safety and soundness. NCUA is pleased that our recommendation has been incorporated into Section 304 of the bill.

One Percent Investment Limit in CUSOs

The Federal Credit Union Act authorizes FCUs to invest in organizations providing services to credit unions and credit union members. An individual FCU, however, may invest in aggregate no more than one percent of its shares and undivided earnings in these organizations (12 USC 1757(7)(I)). These organizations, commonly known as credit union service organizations or "CUSOs," provide important services. Examples are data processing and check clearing for credit unions, as well as services such as estate planning and financial planning for credit union members. When these services are provided through a CUSO, any financial risks are isolated from the credit union, yet the credit unions that invest in the CUSO retain control over the quality of services offered and the prices paid by the credit unions or their members. The one percent aggregate investment limit is unrealistically low and forces credit unions to either bring services in-house, thus potentially increasing risk to the credit union and the insurance Fund, or turn to outside providers and lose control. The one percent limit should be eliminated and the NCUA Board should be allowed to set a limit by regulation. NCUA is comfortable with Section 305 as drafted which increases the CUSO investment limit from 1% to 3%.

Branch and Service Facility "Reasonable Proximity" Statutory Mandate

The Credit Union Membership Access Act enacted in 1998 expressly authorized multiple common-bond credit unions. The Access Act provided, however, that an FCU may add a new group to its field of membership only if the credit union "is within reasonable proximity to the location of the group" (12 USC 1759(f)(1)(B)). This, in effect, could be interpreted to require a credit union to establish a costly physical presence that could potentially, if unchecked, present long term safety and soundness concerns and, unfortunately, in many cases serves as a financial deterrent to credit unions who otherwise have a desire to extend financial services to the group. This geographic limitation on FCU services is unnecessary in today's financial marketplace, where most services can be

provided electronically. This limitation could prevent NCUA from allowing an FCU and a group to match up when it is their wish to do so, and may even prevent NCUA from adding groups to the FCU best suited to serve them. The statutory "reasonable proximity" mandate is an unnecessary hindrance to providing credit union services and should be removed, thus allowing NCUA to define and implement reasonable "ability to serve" requirements. This suggestion is not included in H.R. 1375.

Expanded Investment Options

The Federal Credit Union Act limits the investment authority of FCUs to loans, government securities, deposits in other financial institutions and certain other very limited investments (12 USC 1757(7)). This limited investment authority restricts the ability of FCUs to remain competitive in the rapidly changing financial marketplace. The Act should be amended to provide such additional investment authority as is approved by regulation of the NCUA Board. This would enable the Board to approve additional safe and sound investments of a conservative nature which have a proven track record with state chartered credit unions or other financial institutions. Section 303, as drafted, appropriately addresses the issues NCUA has presented in our recommendation and further establishes specific percentage limitations and investment grade standards in which federal credit unions may operate by statute.

Voluntary Merger Authority

The Federal Credit Union Act, as amended by the Credit Union Membership Access Act, allows voluntary mergers of healthy FCUs, but requires that NCUA consider a spin-off of any group of over 3,000 members in the merging credit union (12 USC 1759(d)(2)(B)(i)). When two healthy FCUs wish to merge, and thus combine their financial strength and improve service to their members, they should be allowed to do so. There is no logical reason to require in connection with such mergers that groups over 3,000, or any group for that matter, be required to spin off and form a separate credit union. These groups are already included in a credit union in accordance with the statutory standards, and that status is unaffected by a merger. NCUA is pleased that Section 308, as drafted, addresses these concerns.

We truly value the even-handed assessment the Committee made regarding our recommendations and those affecting the institutions we charter, regulate, supervise and/or insure, including the needed technical corrections to the Federal Credit Union Act which are also included in Title VII of H.R. 1375.

Regulatory Relief From SEC Registration Requirements

Another item we are pleased to see included in this years' bill (Section 313) is the provision to provide regulatory relief from the requirement that credit unions

register with the Securities and Exchange Commission as broker/dealers when engaging in certain de minimus securities activities. Gramm-Leach-Bliley provided banks with registration relief for certain enumerated activities, and Section 201 of H.R. 1375 addresses this issue as it relates to thrifts and provides thrifts with registration relief for similar activities. The relief sought for credit unions would be more limited in scope and application. Credit union powers are limited by their chartering statutes, and credit unions do not have certain powers, such as general trust powers, that are available to banks and thrifts. The requested parity relief for credit unions would apply only to those activities otherwise authorized for credit unions under applicable credit union chartering statutes, currently including third-party brokerage arrangements, sweep accounts, and certain safekeeping and custody activities.

Additional Credit Union Provisions

We would also like to take this opportunity to comment on other credit union provisions incorporated into this legislation.

We have reviewed all of the additional credit union provisions included in H.R. 1375 and have no safety and soundness concerns whatsoever with these additions. Among these are provisions which address leases of land on Federal facilities for credit unions (Section 302); member business loans for non-profit religious organizations (Section 306); criteria for continued membership of certain member groups in community charter conversions (Section 309); credit union governance changes (Section 310); and revising the economic factors the NCUA Board must use when considering adjustments to the statutory 15% interest rate that can be charged by federal credit unions on loans (Section 311). Again, though we recognize these issues as statutory in nature and therefore a public policy decision only the Congress can make, we have carefully examined each and have determined that these provisions present no safety and soundness concerns for the credit unions we regulate and/or insure. Also, Section 312 of H.R. 1375 was added by the Committee on the Judiciary in 2002 and provides for an exemption from pre-merger notification requirements of the Clayton Act. We have likewise reviewed this provision, and have no objections and actually see benefit from a safety and soundness perspective.

Privately Insured Credit Unions and Federal Home Loan Bank Membership

It is important to recognize that NCUA is neither the regulator nor the insurer of state-chartered credit unions whose deposits are not insured by the National Credit Union Share Insurance Fund. We are therefore unable to provide a safety and soundness evaluation on Section 301 of H.R. 1375. NCUA took no formal position on the original provisions of that section as drafted last year and again have no official position on the public policy issue related to privately insured state-chartered credit unions being eligible to join the Federal Home Loan Bank; however, we find ourselves uncomfortable with changes to Section 301 as

amended by action of the full Committee on June 6, 2002, and again as it appears in Section 301 of HR 1375 in the 108th Congress.

Our concerns stem from language added to the original section which makes it appear that oversight responsibility for non-federally insured credit unions and certain state regulated private share insurance companies rests with NCUA. NCUA has no legal authority, regulatory or supervisory jurisdiction over these non-federally insured credit unions or commercial insurance companies (nor do we seek it). In our view, the language requiring private insurance providers to submit copies of their annual audit reports to NCUA should be removed to avoid potential consumer confusion and misunderstanding. Likewise, we believe that the consultation language which seeks to bring the federal regulatory authority into a role that appropriately rests with state credit union and insurance regulators should also be removed. In its passage of the Federal Deposit Insurance Corporation Improvement Act in 1991 (FDICIA), Congress designated the Federal Trade Commission as the agency responsible for oversight of private deposit insurance companies and the protection of consumers through appropriate disclosure provisions. As the matter remains one of consumer awareness, disclosure and notification -- and not of federal credit union regulation -- NCUA feels strongly that the Federal Trade Commission should retain this oversight responsibility. The additional language which could be interpreted to infer an NCUA role that is neither appropriate nor statutorily authorized to provide oversight to either state-chartered privately insured credit unions or a private insurance company regulated by an agency designated by state statute should be removed from Section 301.

Conclusion

It has been five years since Congress has thoroughly addressed our statute and the regulations that emanate from it. NCUA has now had the benefit of these years of experience working with the changes made to the Federal Credit Union Act by the passage of the 1998 law, as well as many additional years with other provisions we identified as in need of statutory reform or revision. The review and relief sought in this proposed legislation is both needed and timely.

As the Committee continues its work on this legislation it is our belief that, where appropriate and dictated by efficiency and overall concerns for safety and soundness, it would be advisable for the Committee to consider the option to authorize the appropriate regulatory agency to address many of these issues from a regulatory perspective rather than by addressing them specifically in the statute. Such an approach would make it possible for the regulators to adjust, where appropriate, to changing conditions in the marketplace or evolving safety and soundness considerations without the necessity of a statutory revision.

As I stated in my March 14, 2002, testimony before the Subcommittee on Financial Institutions and Consumer Credit regarding this legislation, "our goal at

NCUA as we implement any regulatory relief provisions the Congress ultimately chooses to enact will be to take any and all actions with an eye towards removing unnecessary regulatory burden while maintaining, as is proven by the historical strong performance of America's credit unions, our first and foremost priority and commitment to both safety and soundness and necessary regulation to protect the American public."

On behalf of the NCUA Board, I herein re-state this commitment and again express our appreciation for your consideration and support of NCUA's recommended provisions.

We look forward to working with the subcommittee and committee again this year to draft a regulatory relief bill which will result in stronger credit unions and more responsive credit unions to a changing and dynamic financial marketplace.

Testimony of

GAVIN M. GEE

DIRECTOR OF FINANCE

For the

STATE OF IDAHO

on behalf of the

CONFERENCE OF STATE BANK SUPERVISORS

before the

FINANCIAL SERVICES SUBCOMMITTEE ON

FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

UNITED STATES HOUSE OF REPRESENTATIVES

March 27, 2003

Good morning Chairman Bachus, Representative Sanders and members of the Subcommittee. I am Gavin Gee, Idaho Director of Finance, and Chairman of the Conference of State Bank Supervisors (CSBS). Thank you for asking us to be here today to share the views of CSBS on regulatory burden reduction and the "Financial Services Regulatory Relief Act of 2003." I would also like to thank Representative Capito for her sponsorship of this thoughtful legislation.

CSBS is the professional association of state officials who charter, regulate and supervise the nation's over 6,000 state-chartered commercial and savings banks, and more than 400 state-licensed foreign banking offices nationwide.

We applaud your commitment and efforts to reduce the burdens imposed by unnecessary or duplicative regulations that do not advance the safety and soundness of our nation's financial institutions. This committee deserves special recognition for its efforts to remove these federal regulatory burdens, allowing our banks to compete with other financial entities at home and around the world. This competition encourages efficiency and innovation, benefiting the economy and consumers alike.

The most important contribution toward reducing regulatory burden, however, may be empowering the state banking system. State banks and the flexibility of the state system have created the vast majority of innovations in banking products, services and business structures. CSBS greatly appreciates the commitment of the Congress to preserve and enhance the ability of the states to respond to customer and business needs. Support of dual federal and state chartering will allow our financial markets to continue to be the world's most vigorous.

Choice in the regulatory environment can have many of the same benefits that it has in the business environment. Knowing that banks have a choice,

regulators work smarter and more effectively. The safety and soundness of the financial institutions we regulate is our goal, and it is essential that we have the necessary resources to ensure a healthy banking system. Without the existence of a parallel regulatory system, however, an expensive, inefficient and monolithic regulatory regime could easily develop that would burden and restrict financial institutions, disadvantage them in the marketplace, and create a less healthy banking system. As our founding fathers recognized, we need federalism, not just the federal apparatus, in our banking system.

Through innovation, coordination, and the dynamic use of technology, states have made great strides in reducing regulatory burden for the institutions we supervise. As Congress considers new regulatory burden relief measures, we ask you to ensure that we can continue to pursue these efforts. We also ask you to consider initiatives that will provide equal competitive opportunities for state-regulated and federally-chartered institutions, and that will clarify the interaction of state and federal law and the ability of state governments to protect their citizens.

Innovating to Reduce Regulatory Burden

The state banking departments have always sought to measure each regulatory requirement against its benefit to the public. In supervising state-chartered institutions, we have seen how the cumulative burden of regulatory requirements can have a detrimental effect on the public by diverting banks' resources from lending and other financial services to regulatory compliance.

Over the past few years the states, independently and in conjunction with their federal counterparts, have focused their efforts on reducing the burdens on state-chartered institutions. They have done this by streamlining regulatory procedures, rescinding unnecessary regulations, embracing technology to improve

the examination process, and working together to assure the strength and survival of the state banking system.

Let me briefly mention a few examples.

In addition to robust on-site, risk-focused examination procedures, **46** states have implemented off-site supervisory surveillance monitoring programs. These programs are designed to complement onsite analysis. Off-site surveillance allows regulators to monitor the overall condition of banks between examinations and thereby provides additional tools to promote safety and soundness above and beyond point-in-time examinations. Off-site surveillance also helps regulators plan for the scope (what issues examiners should focus on) before beginning the examination. This increases the overall quality and effectiveness of exams.

North Carolina examiners, for example, analyze monthly financials and follow up with visitations and/or inquiries to their banks. The Massachusetts Division of Banking has pre-examination procedures in place to ensure that the scope of each examination is tailored to the institution and will capture the areas or functions that are determined to pose the highest level of risk. Examination teams, particularly the Examiners in Charge, use the information gathered offsite to assess the bank's risk profile and note any developments since the previous examination. Michigan's Banking Department has established a new unit that reviews the activities of a financial institution as a whole -across its business lines- and apprises various specialists.

Twenty-five states now allow their state-chartered banks to incorporate as limited partnerships and subchapter S corporations for state tax purposes. This provides additional flexibility for institutions that seek an organizational structure other than a traditional corporation.

Authorizing mobile branches is another step states have taken to improve flexibility and create opportunities for banks to serve a broad range of communities. Forty-one state banking departments now allow these facilities, which especially help l rural and low-to-moderate income areas.

I do not mean to suggest, by citing these examples, that all fifty states will or should enact these provisions. One of the dual banking system's chief virtues is that it permits innovation and experimentation at a more local level. New ideas can thus be tested and refined in one or several states before they are adopted nationwide.

Many states have focused their attention on making bank regulation more efficient, and have implemented a "best practices" strategy toward regulation. And, of course, all states have worked hard to keep examination fees and supervisory assessments low for their banks.

Coordinating to Reduce Burden in an Interstate Environment

Coordination and cooperation have been hallmarks of state bank supervision since the early 1990s. CSBS strongly believes that a system of multiple regulators can actually reduce regulatory burden by preventing a financial regulatory oligarchy. To accomplish this, however, all regulators must coordinate and cooperate in supervising any one institution.

The state banking departments have done much to reduce regulatory burden not just individually, but as a system. With Riegle-Neal's enactment in 1994, CSBS formed, with the FDIC and the Federal Reserve System, the State-Federal Working Group. The working group's goal is to minimize conflicts and duplication among the state and federal bank regulators in supervising interstate state-chartered banks.

Separately and through the State-Federal Working Group, the state banking departments developed two agreements: the Nationwide Cooperative Agreement, signed by all 54 state banking departments, and the Nationwide State/Federal Supervisory Agreement, signed by the states, the FDIC and the Federal Reserve. Signed in November 1996, the Nationwide Agreements – unanimously agreed to by the state banking departments, the Federal Reserve and the FDIC – were the culmination of two years of work toward a system of "seamless supervision" for the interstate operations of state-chartered banks. The agreements serve as a model for cooperation and coordination between the states and the federal regulators.

The agreements provide a single regulatory point of contact for state-chartered banks that branch across state lines. Federal and state regulators have each designated a single point of contact for the overall supervision of a multi-state bank. Most recently, the Working Group produced a single uniform application for interstate branching. To date, over two-thirds of the states have adopted this form, and more are considering its adoption.

Our coordination efforts benefit all financial institutions operating in the United States, not just domestic banks. Through a CSBS-led effort, state and federal bank regulators signed agreements in 1998 to create a streamlined system for the supervision of U.S. offices of foreign banks across state lines. These agreements, signed by the states, the Federal Reserve and the FDIC, are modeled after the domestic agreements for interstate supervision.

These agreements seek to improve coordination and cooperation in the supervision of the multi-state operations of foreign banking organizations that operate under a state license or charter. They provide for a seamless supervisory process with minimal regulatory burden, and ensure that supervision is flexible and commensurate with the bank's structure and risk profile.

Looking beyond depository institutions, we realize that providing trust services has increasingly become an interstate business. The states have adapted by developing a model form states can use for processing requests for state-chartered institutions to operate on a multistate basis.

At the state level, to further this necessary cooperation and coordination, we have formed joint task forces with the National Association of Insurance Commissioners (NAIC), the North American Securities Administrators Association (NASAA). The purpose of these task forces is to share information and, where appropriate, to coordinate supervision toward our mutual goal: a wide range of safe, responsible, accessible financial services for our states' citizens.

To facilitate this coordination, regulators representing the Conference of State Bank Supervisors (CSBS) and the National Association of Insurance Commissioners (NAIC) jointly developed a model agreement to improve the coordinated supervision and regulation of banks engaged in insurance sales.

This effort has helped supervisors avoid imposing regulatory burdens, such as making redundant requests for information or failing to coordinate responses to consumer complaints. Coordination in these areas should benefit banks engaged in insurance sales and lead to more efficient, streamlined supervision.

Efforts such as these recognize that while the differences in law allowed by our dual banking system often produce innovation, some differences can inhibit the competitiveness of our financial institutions. We are committed, as a state system, to fostering diversity while working toward certain consistent goals. We recognize that we must encourage a broad range of opportunity, while giving financial institutions a degree of certainty and consistency so that they can serve

their customers effectively across state lines. This is the true value of the state charter – it is a charter of choices.

Role of Technology

State banking agencies also use technology to reduce regulatory burden. Individual states have been able to streamline their regulatory procedures through technological enhancements. In my own state, Idaho, we now accept all forms and applications online and also allow financial institutions and licensees to pay their fees online. A number of other states have made similar advances. Illinois will soon be the first state banking department to cross-certify its public-key infrastructure with the federal government's Federal Bridge Certification Authority. Other states have instituted other technological conveniences, such as ACH transactions for assessment payments. Some allow online access via the Internet for institutions to view and maintain their own information, such as addresses, key officer changes, and branch and subsidiary office locations.

Seven state banking agencies -- Alaska, Florida, Georgia, Maine, Minnesota, Nebraska and Tennessee -- allow banks to file applications electronically, such as through the Department's website. **Thirty-four** states have adopted an interagency federal application that allows would-be bankers to apply simultaneously for a state or national bank or thrift charter and for federal deposit insurance. The state banking agencies worked through CSBS with the federal banking departments to draft a uniform, consistent application for the industry.

Through the use of shared technology, state and federal banking agencies work together continuously to improve the quality of the examination process, while making the examination process less intrusive for financial institutions.

Through CSBS, the state banking departments have played a pivotal role in

coordinating efforts with the federal regulators to develop and improve several automated examination tools that will strengthen the examination process and facilitate more efficient, risk-focused, quality examinations. Our goals are to make the time examiners spend in the institution more productive, and to expedite the entire examination process, thus freeing bank management to devote their efforts to the business of banking.

"FINANCIAL SERVICES REGULATORY RELIEF ACT OF 2003"

We would like to thank the Committee for considering our views on the "Financial Services Regulatory Relief Act of 2003."

Interstate Branching

Current Federal law takes an inconsistent approach toward how banks may branch across state lines. While Riegle-Neal gave the appearance that states could control how banks could enter and branch within their borders, this has not always been the reality.

Perhaps because many believed that the Federal thrift charter would be eliminated at the time Riegle-Neal was adopted, the law was not applied to federally-chartered thrifts. The result is that a Federal thrift can branch without regard to state law and rules of entry.

Since the passage of Riegle-Neal, the Office of the Comptroller of the Currency has promulgated creative interpretations of the National Bank Act that effectively circumvent the application of Riegle-Neal to "branch-like" operations. CSBS has unsuccessfully opposed these interpretations in comment letters and as a friend of the court on several occasions.

These interpretations have placed state-chartered institutions, particularly community banks in multistate markets, at a competitive disadvantage to those larger, federally-chartered institutions that can branch without restriction.

States have had to address this disadvantage by changing the laws being circumvented. Since the passage of Riegle-Neal, a number of states have moved to allow *de novo* branching. Seventeen states now allow *de novo* branching, most on a reciprocal basis. In December 2001, the CSBS Board of Directors approved policy to encourage all states to consider enacting *de novo* branching laws.

We appreciate your revisiting the Riegle-Neal Act, and we urge Congress to eliminate the disadvantage it has created for state banks because of inconsistent application of Federal law. We are especially glad that your review included language that addresses the disadvantage for state trust operations created by OCC and OTS interpretations.

Other Suggestions

State Member Bank Parallel Treatment

In particular, CSBS encourages you to grant the Federal Reserve more flexibility to allow state member banks to engage in investment activities authorized by their chartering state and approved by the FDIC as posing no significant risk to the deposit insurance fund.

This amendment would remove a provision in the Federal Reserve Act that places unnecessary limitations on the powers of a state member bank, limiting state member banks to the activities allowed for national banks. As state-chartered nonmember banks have always been allowed to exercise expanded powers – within the confines of safety and soundness – it is an appropriate regulatory relief effort to eliminate this prejudicial and unnecessary distinction between state-

chartered member banks and state-chartered nonmember banks. This provision does away with this arcane restriction, which has no basis in promoting safety and soundness.

As you know, Congress has consistently reaffirmed the states' ability to craft banking charters to fit their economic needs and experiment with new products and services. Congress once again reaffirmed this authority in 1991, when FDICIA allowed states to continue to authorize powers beyond those of national banks.

An empowered state banking system is essential to the evolution of our banking system and elemental to state economic development. This change would help to advance that goal.

Limited Liability Corporations

The states and CSBS have a long history of advocating and facilitating innovations within the banking industry, including organizational structures available to state-chartered banks. In that regard, CSBS has strongly supported an FDIC proposal to make federal deposit insurance available to state chartered banks that organize as limited liability companies (LLC). An LLC is a business entity that combines the limited liability of a corporation with the pass-through tax treatment of a partnership. Through a proposal released for public comment last summer and recently finalized, the FDIC has determined that state banks organized as LLCs are eligible for federal deposit insurance if they meet established criteria designed to insure safety and soundness and limit risk to the deposit insurance fund.

Only a small number of states now allow state-chartered banks to organize as LLCs, including Maine, Nevada, Texas and Vermont. Discussions with state banking agencies, however, indicate that several states may consider this option in

the future. State banking departments and bankers alike are interested in the LLC operational structure because LLCs offer the same tax advantage (pass-through tax treatment) as Subchapter S corporations, with greater flexibility. LLCs, for example, are not subject to the limits on the number and type of shareholders that apply to a Subchapter S corporation. It remains an open question, however, whether pass-through taxation status for federal income tax purposes will be available to state banks organized as LLCs. An Internal Revenue Service regulation currently blocks pass-through tax treatment for state-chartered banks. Despite this prohibition, there are reportedly state tax advantages.

We ask the Committee to work with the Ways and Means Committee to encourage the IRS to rethink its interpretation of the tax treatment of state-chartered ILCs.

During this time when all corporations, including banks, find themselves under increased scrutiny for sound operating procedures, robust corporate governance standards, and ethical business practices, banks organized as LLCs are subject to no less regulatory scrutiny or operating requirements than traditional banks. In fact, the full range of requirements that apply to banks organized as traditional corporations, including enforcement and supervisory authority in the Federal Deposit Insurance Act, applies to LLCs. State banks organized as LLCs must also meet all of the safety and soundness related requirements of the state banking agency that charters the institution.

Federal Financial Institutions Examination Council

Improved coordination and communications between regulators clearly benefits bankers and reduces regulatory burden. In that spirit, we suggest that Congress could improve the Federal Financial Institutions Examination Council (FFIEC) by changing the state position from one of observer to that of full voting member. State bank supervisors are the chartering authorities for nearly seventy

percent of the banking industry, and are thus vitally concerned with changes in regulatory policy and procedures.

Review of Regulatory Preemption

We also ask the Committee and the Congress to address the implementation and implications of regulatory preemption by the Office of the Comptroller of the Currency and the Office of Thrift Supervision.

The OTS currently does not publish its preemptive decisions because of the agency's interpretation of the Home Owners' Loan Act, and because Congress has not applied the guidelines for preemption articulated in the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 to the OTS.

The banking system would benefit greatly from a more open dialogue between the federal government and the states about applicable law for federally chartered financial institutions.

The states are increasingly concerned about the growing boldness of OCC and OTS preemption. The OCC has asserted that it is only interpreting the National Bank Act in its preemptions, and is merely reflecting congressional intent. The OTS makes similar claims. CSBS respectfully disagrees. We believe that regulatory interpretations have moved away from well-considered public policy into the realm of loophole –lawyering. It is one thing for the Congress to openly and publicly debate policy and establish federal standards. It is quite another when a regulator proposes cleverly worded interpretations that a clear reading of the law would not support. The Congress has a role in reviewing the growing expanse of state consumer protection laws being preempted for national banks, federal thrifts and now their subsidiaries.

CSBS believes this request for review of preemption and applicable law is appropriately a regulatory burden reduction matter. Our banking system – particularly for state-chartered institutions – is a complex and evolving web of state and federal law. Greater sunshine on OCC and OTS interpretations of applicable law for the institutions they charter would also help clarify applicable law for our nation's over 6,000 state-chartered banks.
A clearer articulation of OCC and OTS standards of preemption would also lessen the legal burden of litigation over the federal regulators' sometimes tenuous interpretations of applicable law.

We need a banking system that both acknowledges the needs of multistate banks and financial services firms and protects consumers. Given that consumer needs can vary considerably across our nation, and that the states are closer to their citizens, we believe that consumer protection is often best addressed at the state level. CSBS is committed to working with the Congress to address the needs of an evolving nationwide financial services system in a way that respects the interests of all our nation's financial services providers and minimizes regulatory burden, while also protecting our nation's consumers.

Conclusion

The quest to streamline the regulatory process while preserving the safety and soundness of our nation's financial system is critical to our economic well-being and to the health of our nation's financial institutions. Like you, and like our federal agency counterparts, we at the state level are constantly balancing the public benefits of regulatory actions against their direct and indirect costs. Our most important guide is the fundamental principle of safety and soundness.

We commend this Committee for its efforts in this area. State bank supervisors appreciate the Committee's interest in eliminating barriers in federal law to innovation from the state charter. We thank you for this opportunity to

testify on this very important subject, and look forward to any questions you and the members of the Subcommittee might have.

STATEMENT OF

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on the

"Financial Services Regulatory Relief Act of 2003"

before the

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS
AND CONSUMER CREDIT

of the

COMMITTEE ON FINANCIAL SERVICES
U.S. HOUSE OF REPRESENTATIVES

March 27, 2003
Room 2128, Rayburn House Office Building

Mr. Chairman, Representative Sanders, Representative Capito and Members of the Subcommittee, I appreciate the opportunity to present the views of the Federal Deposit Insurance Corporation (FDIC) on H.R. 1375, proposed legislation to provide regulatory burden relief. The FDIC shares the Subcommittee's continuing commitment to eliminate unnecessary burden and to streamline and modernize laws and regulations as the financial industry evolves.

In my testimony today, I will first highlight the FDIC's efforts to reduce regulatory burden in areas where statutory change may not be necessary. Next, I will address specific provisions in the proposed legislation that the FDIC requested to improve our performance. Finally, I will suggest additional provisions for inclusion in the proposed legislation.

FDIC EFFORTS TO RELIEVE REGULATORY BURDEN

The FDIC continues to place considerable emphasis on achieving ways of reducing regulatory burden without compromising safety and soundness and consumer protection. In 2002, Chairman Powell charged a task force within the FDIC to study ways to reduce the regulatory burden that may result from the agency's activities. The task force solicited suggestions on reducing burden from FDIC staff and the public.

Based on our analysis of more than 400 comments received, the FDIC has targeted several initiatives for implementation:

1) providing for electronic filings of branch applications and exploring alternatives for further streamlining the application process for deposit insurance in connection with new charters and mergers;
2) providing more user-friendly delivery of important information to banks by consolidating outstanding directives and providing a web-based search function for Financial Institution Letters;
3) simplifying deposit insurance rules -- especially for living trust accounts; and
4) developing a system for routine sharing of information on overall and regional-specific examination trends and findings with local institutions.

In addition, FDIC Vice Chairman John Reich is leading a Federal Financial Institutions Examination Council (FFIEC) effort to conduct a thorough review of all regulations to identify outdated or otherwise unnecessary regulations. This interagency project includes both an internal review of regulations unique to the FDIC and a joint review of interagency regulations. While this review is mandated by the Economic Growth and Regulatory Paperwork Reduction Act of 1996 (EGRPRA), it is not due until 2006. By advancing it as we have, the FDIC regards the review as an opportunity to emphasize our ongoing efforts to lessen regulatory burden and identify other areas of regulatory overlap and inefficiency.

The FDIC also is leading interagency efforts to implement an improved program for collecting, managing and distributing Call Report information. The Call Report data will be managed in a secure central facility and will allow faster and consistent exchanges of critical financial data. This program will use Extensible Business Reporting Language (XBRL), a data standard for transporting and displaying financial reporting information using the Internet. Data accuracy and timeliness will be enhanced by providing banks, regulators and others with precise definitions, instructions and validation criteria in XBRL format. The FDIC is working with other regulators, accounting firms, software companies and financial services providers around the world to promote transparency, processing efficiency and improved risk management techniques using new data standards.

The FDIC is extensively engaged in efforts to provide regulatory relief for the industry through streamlining the examination processes and procedures with an eye toward better allocating FDIC resources to areas that could pose greater risk to the insurance funds -- such as problem banks, large financial institutions, technology, high risk lending, internal controls and fraud. Highlights of these and other FDIC efforts to reduce burden include:

1) revision of the report of examination to make it more straightforward and consolidation of several schedules to reduce redundancies and highlight significant findings;
2) designation of subject matter experts who specialize on applications to promote greater consistency and more timely processing of applications;

3) establishment of several corporate governance initiatives to assist bankers and bank directors including:

    - enhancement of an existing director involvement program where directors will be invited to participate in regularly scheduled meetings between FDIC examiners and bank officials;
    - establishment on the FDIC website of a "Director's Corner" as a one-stop site for directors looking for useful and practical information to assist in fulfilling their responsibilities; and
    - expansion of the FDIC's Directors' College program, particularly for newer directors;

4) enhancement of outreach and examination communication through a new automated post-examination survey where bankers can provide their candid and confidential thoughts on the examination process and request Washington office contact;

5) expanded and targeted outreach programs for areas of high interest or rapid changes, such as information technology, real estate lending, consumer compliance, and agricultural lending;

6) establishment of a dedicated cadre of specialized and expert Information Technology (IT) examiners who focus on complex organizations with a greater exposure to technology risk; improved efficiencies of the IT examination procedures; and, streamlining of IT examinations for institutions that pose the least technology risk;

7) targeted and more efficiently focused examinations of trust activities according to institutions' risk profiles;

8) streamlined and customized requests for information from institutions prior to examinations;

9) adoption of the Maximum Efficiency Risk-Focused Institution Targeted (MERIT) Guidelines. This program has improved effectiveness by maximizing the use of risk-focused examination procedures in well-managed banks in sound financial condition, and has reduced the average time spent conducting risk management examinations by well over its original 20 percent target in qualifying institutions. This has allowed us to focus more resources on problem institutions and other high-risk areas;

10) implementation of a new interagency agreement that addresses information sharing among financial institution regulatory agencies, FDIC participation in examinations of financial institutions that present heightened risk to the insurance funds, and FDIC involvement in the supervision of certain large banks -- including establishment of the FDIC's dedicated examiner program for the eight largest insured institutions;

11) revision of the compliance examination to place greater emphasis on an institution's administration of its compliance responsibilities versus transaction testing, and empowerment of examiners to offer suggestions about how to rectify weaknesses that may be found;

12) implementation of an interagency charter and federal deposit insurance application that eliminates duplicative information requests by consolidating into

one uniform document the different reporting requirements of the three regulatory agencies (FDIC, OCC, and OTS);

13) realignment of FDIC regional office and field territory responsibilities to give greater authority and responsibility to front-line employees. This realignment will increase our responsiveness to the industry and capitalize on the knowledge of field staff to better analyze the risks of institutions in their localized areas;

14) provision to bankers of a customized version of the FDIC Electronic Deposit Insurance Estimator (EDIE), a CD-ROM and downloadable version of the web-based EDIE that allows bankers easier access to information to help them determine a customer's insured funds.

In addition to the initiatives outlined above, the FDIC continues to provide timely information on major issues to the industry and general public through its ***For Your Information*** reports. Recent reports featured the new Basel Capital Accord, payday lending, real estate markets, and syndicated credit risks. While the FDIC continues to provide in-depth information on regional and national economic and banking trends through its ***FDIC Outlook***, it recently launched a new internet publication - ***FDIC State Profiles*** - that provides analysis of state economic and banking trends and aggregate information on institutions in all 50 states, Puerto Rico and the U.S. Virgin Islands.

Chairman Powell remains keenly interested in exploring all kinds of measures to eliminate inefficiencies and costs in the supervisory and regulatory systems. For example, he raised fundamental questions about the efficacy of the current regulatory

structure and the confusion of competing jurisdictions, overlapping responsibilities, and cumbersome procedures. Earlier this month the FDIC hosted a symposium on the future of the structure of financial regulation as part of a continuing initiative to examine vital policy questions.

THE FINANCIAL SERVICES REGULATORY RELIEF ACT OF 2003

The FDIC commends the Subcommittee for holding this hearing and Representative Capito for introducing legislative changes to lessen the regulatory compliance burden on insured depository institutions and improve their productivity. The FDIC's staff has worked closely with the Subcommittee in developing several of the provisions contained in the proposed legislation, including some that also will help the FDIC become more efficient and effective in its regulation of insured institutions. The FDIC enthusiastically supports several statutory provisions of the legislation as described below.

Clarification of Section 8(g) Prohibition Authority

Section 8(g) of the Federal Deposit Insurance Act (FDI Act) provides the appropriate Federal banking agency with the authority to suspend or prohibit individuals charged with certain crimes from participation in the affairs of the depository institution with which they are affiliated. The FDIC supports Section 606 of H.R. 1375 that clarifies that the agency may suspend or prohibit those individuals from participation in the affairs of any depository institution and not solely the insured depository institution with which

the institution affiliated party is or was associated. The provision will make clear that a Federal banking agency may use the Section 8(g) remedy even where the institution that the individuals were associated ceases to exist.

Judicial Review of Conservatorship and Receivership Appointments

The FDIC supports Section 402 of H.R. 1375 that specifies the time period during which the appointment, in certain circumstances, of the FDIC as conservator or receiver of a failed insured depository institution could be challenged. Moreover, this provision provides greater certainty to the receiver's activities and those doing business with the receiver.

Currently, some provisions of Federal law specify a 30-day period for challenges after appointment. In contrast, other provisions of the FDI Act that govern appointment of a conservator or receiver by the appropriate Federal banking agencies for a State institution under prompt corrective action provisions and the FDIC's appointment of itself as conservator or receiver for an insured depository institution are silent on the limitations period for challenges to those appointments. At least one court has previously held that the Administrative Procedure Act applied because the National Bank Receivership Act was silent regarding the time period for challenging such an appointment. The court held that the national bank had six years from the date of appointment to challenge the action. The proposed legislation remedies the silence in the National Bank Receivership Act and in the FDI Act consistent with the parallel

provisions in Section 5 of the Home Owners' Loan Act and another appointments provision of the FDI Act.

Change in Bank Control Act Amendment

The FDIC supports Section 409 of the proposed legislation that amends the Change in Bank Control Act to address an issue that arises when a "stripped charter" institution is the subject of a change-in-control notice. A stripped charter is essentially a bank charter with insurance, but without any significant ongoing business operations. Such "stripped charters" can result after a purchase and assumption transaction where the assets and liabilities of an institution are transferred to an acquiring institution, but the charter remains and may have a value attached to it.

The Change in Bank Control Act provides the appropriate Federal banking agency with authority to disapprove a change-in-control notice within a set period of time. The availability of stripped charters for purchase in the establishment of new banking operations is sometimes used as an alternative to de novo charter and deposit insurance applications. Change-in-control notices are subject to strict time periods for disapproval and extensions of time beyond the 45 days for review. These time frames place significant pressures on the agencies when they are required to analyze novel or significant issues or complex or controversial business proposals. For example, issues presented by change-in-control notices proposing control by non-resident foreign nationals, or issues presented where third parties are proposed to have significant participation in the bank's operations, generally require additional scrutiny to satisfy

safety and soundness concerns. The FDIC supports the provisions of H.R. 1375 that clarify the bases for which such notices may be disapproved and expand the bases for extensions of time for consideration of certain notices raising novel or significant issues. The amendment is a safety and soundness measure that would greatly increase the agencies' ability to adequately consider the risks inherent in a proposed business plan and to use that information in determining whether to disapprove a notice of change-in-control.

Recordkeeping Amendment

The FDIC supports Section 604 of the bill that modifies the requirement for retention of old records of a failed insured depository institution at the time a receiver is appointed. Currently, the statute requires the FDIC to preserve all records of a failed institution for six years from the date of its appointment as receiver, regardless of the age of the records. After the end of six years, the FDIC can destroy any records that it determines to be unnecessary, unless directed not to do so by a court or a government agency or prohibited by law. Consequently, the FDIC must preserve for six years very old records that have no value to the FDIC or to any pending litigation.

The proposed provision allows the FDIC to destroy records that are 10 or more years old at the time of its appointment as receiver, unless directed not to do so by a court or a government agency or prohibited by law. This change benefits the FDIC or acquirers of failed institutions by reducing the storage costs for these outdated records.

Preservation of Records by Optical Imaging and Other Means

The FDIC supports Section 605 of H.R. 1375 to permit the FDIC to rely on records preserved electronically, such as optically imaged or computer scanned images, as well as the "preservation of records by photography" as the statute currently provides.

Under present law, the FDIC is permitted to use "permanent photographic records" in place of original records for all purposes, including introduction of documents into evidence in State and Federal court. The substance of the statute has been unchanged since 1950. Because of the advent of electronic information systems and imaging technologies that do not have any photographic basis, this amendment would significantly aid the FDIC in preservation of documents by newer methods. In addition, it can be expected that the technology in this area will continue to develop. This amendment is intended to provide the FDIC with the flexibility to rely on appropriate new technology, while retaining the requirement that our Board of Directors prescribe the manner of the preservation of records to ensure their reliability, regardless of the technology used.

Parity in Standards for Institution-Affiliated Parties

The FDIC supports Section 614 of the proposed legislation that would make it easier for regulators to take enforcement actions under section 8 of the FDI Act against independent contractors, such as outside accountants, attorneys, and appraisers, who breach their fiduciary duty, engage in unsafe and unsound practices, or participate in violations of laws, regulations, cease and desist orders, or conditions in connection with

applications or written agreements between depository institutions and banking agencies. In recent years, banking regulators have seen an increase in audit and internal control deficiencies at many insured depository institutions. Some of the deficiencies have caused significant operating losses and led to failures. Accountants who serve as independent contractors play a key role in providing for accurate books and records and in attesting to the adequacy of an institution's internal controls.

At present, independent contractors are treated more leniently under the enforcement provisions of the FDI Act than are directors, officers, employees, controlling stockholders, consultants, and joint venture partners who participate in the affairs of an insured depository institution. In order for the FDIC to take an enforcement action against an independent contractor as an institution-affiliated party the FDIC is required to prove that the contractor "knowingly or recklessly" participated in violations of law or regulation, breaches of fiduciary duty, or unsafe or unsound practices – and that those acts caused, or would likely cause more than a minimal financial loss to the insured depository institution or have a significant adverse effect on it. These requirements do not apply to other parties associated with insured institutions. The current standard is so high that it has made it extremely difficult to take enforcement actions against independent contractors such as accountants. The amendment holds such contractors to a standard closer to the standard for other institution-affiliated parties and provides added incentives for contractors to act responsibly. In addition, it strengthens the ability of the agencies to take enforcement actions against the contractors for fiduciary breaches or unsafe practices.

Amendment Clarifying FDIC's Cross Guarantee Authority

The FDIC is pleased that H.R. 1375 contains a provision necessary to correct a gap in current law regarding cross guarantee liability. As part of the Federal Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA), Congress established a system that permits the FDIC to assess liability for FDIC losses caused by the default of an insured depository institution. Cross guarantee liability, however, is currently limited to commonly controlled insured depository institutions as defined in the statute. Because the statutory definition does not include certain types of financial institutions such as credit card banks that are controlled by nonbank holding companies, liability may not attach to insured institutions that are owned by the same nonbank holding company.

Over the years, a growing number of companies have acquired, either directly or through an affiliate, one or more credit card banks, trust companies, industrial loan companies, or some combination of those types of institutions. Because these companies do not fall within the scope of depository institution holding companies for common control purposes, in the event of default, the FDIC may not be able to assess cross guarantee liability as envisioned in the statute. Section 407 of the proposed legislation corrects language to strengthen the FDIC's efforts to protect the deposit insurance funds when it is determining whether and to what extent to exercise its discretionary authority to assess cross guarantee liability. The assessment of liability would continue to be only

against the insured depository institution under common control with the defaulting institution.

Amendment Clarifying the FDIC's Golden Parachute Authority

The FDIC also supports Section 408 of H.R. 1375 that amends section 18(k) of the FDIC Act to clarify that the FDIC could prohibit or limit a nonbank holding company's golden parachute payment or indemnification payment. In 1990, Congress added this section to the FDI Act and authorized the FDIC to prohibit or limit prepayment of salaries or any liabilities or legal expenses of an institution-affiliated party by an insured depository institution or depository institution holding company. Such payments are prohibited if they are made in contemplation of the insolvency of such institution or holding company or if they prevent the proper application of assets to creditors or create a preference for creditors of the institution. Due to the statutory definition of depository institution holding company, it is not clear that the FDIC is authorized to prohibit these types of payments made by nonbank holding companies. Some examples are companies that own only credit card banks, trust companies, or industrial loan companies.

The lack of clear authority for the FDIC to prohibit payments made by nonbank holding companies to institution-affiliated parties frustrates the purpose of the legislation by allowing nonbank holding companies to make golden parachute payments when an institution is insolvent or is in imminent danger of becoming insolvent to the detriment of the institution, the insurance funds, and the institution's creditors. The proposed

amendment strengthens the FDIC's efforts to protect the insurance funds and ensure that an insured institution does not make these payments to the detriment of the institution.

Enforcement of Agreements and Conditions

The FDIC applauds inclusion of Section 405 that enhances the safety and soundness of insured depository institutions and protects the deposit insurance funds from unnecessary losses. The proposed amendment provides that the Federal banking agencies may enforce (i) conditions imposed in writing, and (ii) written agreements in which an institution-affiliated party agreed to provide capital to the institution. The proposal similarly would clarify existing authority of the FDIC as receiver or conservator to enforce written conditions or agreements entered into between insured depository institutions and institution-affiliated parties and controlling shareholders.

In addition, the proposal eliminates the requirement that an insured depository institution be undercapitalized at the time of a transfer of assets from an affiliate or controlling shareholder to the insured institution in order to prevent a claim against a Federal banking agency for the return of assets under bankruptcy law. Under Section 18(u) of the FDI Act, protection against a claim for the return of assets would still require that, at the time of transfer, the institution must have been subject to written direction from a Federal banking agency to increase its capital and, for that portion of the transfer made by a broker, dealer, or insurance firm, the Federal banking agency must have followed applicable procedures for those functionally regulated entities.

Enforcement Against Misrepresentation Regarding FDIC Deposit Insurance Coverage

The FDIC notes that H.R. 1375 includes a provision in Section 615 that provides the FDIC with enforcement authority to impose civil money penalties for misuse of the FDIC's name or logo, or for any misrepresentation that a deposit is insured by the FDIC. Section 615 of the bill was included at the suggestion of the FDIC's Office of the Inspector General. In particular, this proposal is aimed at persons who prey on depositors, especially elderly or unsophisticated depositors. Unfortunately, as currently drafted, Section 615 does not provide the FDIC a workable method of enforcement. The FDIC staff will be working closely with the Subcommittee's staff to present an amendment that will accomplish the goal of effective enforcement against misrepresentations of deposit insurance or any guarantee of deposits by the FDIC.

The FDIC supports a number of provisions that were requested by our fellow regulators and included in the proposal. For example, we support provisions that streamline merger application requirements, and that permit bank examiners to receive credit from any insured depository institution as long as the credit is issued under the same terms and conditions as credit generally offered to the public. Moreover, the bill makes a number of changes to update or conform existing statutes that we believe are quite useful.

OTHER ISSUES FOR INCLUSION IN THE BILL

The FDIC recommends that the Subcommittee include the following additional regulatory relief items in the bill. The appendix to my testimony contains the relevant legislative language.

Authority to Enforce Conditions on the Approval of Deposit Insurance

The FDIC supports an amendment to Section 8 of the FDI Act to provide each of the other three appropriate Federal banking agencies with express statutory authority to take enforcement action against the banks they supervise based upon a violation of a condition imposed by the FDIC in writing in connection with the approval of an institution's application for deposit insurance.

The FDIC frequently imposes written conditions when approving deposit insurance to a de novo bank or thrift pursuant to Section 5 of the FDI Act (application for deposit insurance). Because of a drafting anomaly under current law, the other three appropriate Federal banking agencies cannot enforce violations of deposit insurance conditions by their supervised institutions. Currently, our only recourse—for institutions that we do not serve as primary regulator—is to commence deposit insurance termination proceedings. This provision would provide express enforcement authority for the involved institution's appropriate Federal banking agency.

Clarification of Section 8 Enforcement Actions that Change-in-Control Conditions are Enforceable

The FDIC recommends for inclusion in the proposed legislation language that clarifies the appropriate Federal banking agencies' authority to take enforcement action against the banks they supervise based on a violation of a condition imposed in writing in connection with any action by the agency on an application, notice, or other request by an insured depository institution or institution-affiliated party. The agencies frequently provide conditions on applications, notices, or other requests, and the proposed change to Section 8 of the FDI Act would expressly provide that this enforcement authority applies equally to conditions imposed in connection with notices and to applications, notices, or other requests by an institution-affiliated party.

Deposit Insurance Related to the Optional Conversion of Federal Savings Associations

Under a provision adopted in the Gramm-Leach-Bliley Act (Section 739), Section 5(i)(5) of the Home Owners' Loan Act permits Federal savings associations with branches in one or more states to undergo a conversion into one or more national or state banks. Such conversions require the approval of the OCC and/or the appropriate state authorities. However, Section 739 does not specifically mention either deposit insurance or the FDIC.

The FDIC supports an amendment to Section 739 clarifying that conversions under that section, which result in more than one bank, would continue to require deposit insurance applications from the resulting institutions, as well as review and approval by

the appropriate Federal banking agency. A one-to-one conversion does not change the risk to the deposit insurance funds because it involves one institution simply changing charters. However, a "breakup conversion" presents a potential increase in risk to the insurance funds because two or more institutions are created with risk profiles that differ from the original institution.

Bank Merger Act and Bank Holding Company Act

The FDIC supports amendments to the Bank Merger Act and Bank Holding Company Act to require consideration of the potentially adverse effects on the insurance funds of any proposed bank merger transaction or holding company formation/ acquisition. As presently written, these laws do not require that any specific consideration be given to a transaction's possible impact on the deposit insurance funds. The omission is noteworthy and potentially damaging to the financial viability of the funds.

Language specifying consideration of risks to the insurance funds already exists for consideration of other transactions. For example, regarding change in control of insured banks, the FDI Act provides authority to the appropriate Federal banking agency to disapprove any proposed acquisition if the agency determines that the proposed transaction would result in an adverse effect on the Bank Insurance Fund or the Savings Association Insurance Fund.

In addition, Section 207 of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) amended Section 6 of the FDI Act to include a new factor—"the risk presented by such depository institution to the Bank Insurance Fund or the Savings Association Insurance Fund"—that must be considered in granting deposit insurance. Additional parallels can also be found in Sections 24 and 28 of the FDI Act.

Given the potential insurance risks inherent in transactions involving large diversified financial services organizations, the addition of an "adverse effect on the deposit insurance funds" assessment factor as a requirement under the Bank Merger Act and Bank Holding Company Act would seem warranted. As with the other factors, each of the agencies would be required to make a separate "adverse effect on the deposit insurance funds" evaluation during its review of the proposed transaction. The intent would be to ensure that the financial integrity of the BIF and the SAIF are prime considerations in any proposed combination. As indicated, there is precedent in other bank application reviews and we believe a compelling case can be made for its inclusion in both the Bank Merger Act and the Bank Holding Company Act.

Automatic Stay

The FDIC recommends inclusion in the bill of an amendment to Section 11 of the FDI Act to allow a conservator and a receiver a brief "breathing period" of 45 days or 90 days, respectively, during which contract terminations, legal action, or other action affecting the assets and liabilities of a bank in conservatorship or receivership would be barred. This amendment is patterned after the Bankruptcy Code automatic stay, and

supplements the bar on termination of contracts due to the appointment of a conservator or receiver in the FDI Act. Currently a conservator or receiver has the power to seek a stay of legal actions following appointment of a receiver which must be granted by any court with jurisdiction of such action or proceeding. The proposed amendment would make such a stay more broadly applicable.

The FDIC also suggests including language that will:

1) provide for the expansion of the scope of the National Flood Insurance Act to apply to mortgage companies that are subsidiaries of financial services holding companies;

2) provide for more discretion on the part of the Federal entity responsible for lending regulation to impose civil money penalties in findings of patterns or practices of violations of flood insurance requirements;

3) provide for the FDIC in its role as receiver of failing institutions to gain access to individual FICO scores to improve the FDIC's ability to evaluate assets and recommend transaction structures for failing banks;

4) clarify the provision of the FDI Act relating to the resolution of deposit insurance disputes in the case of failed insured depository institutions; and

5) exclude from the Federal Advisory Committee Act advisory committees to the banking agencies.

CONCLUSION

Thank you for the opportunity to present the FDIC's views on these issues. The FDIC supports the Subcommittee's continued efforts to reduce unnecessary burden on insured depository institutions without compromising safety and soundness or consumer protection. We continually strive for more efficiency in the regulatory process and are pleased to work with the Subcommittee in accomplishing this goal.

APPENDIX

LEGISLATIVE LANGUAGE FOR FDIC RECOMMENDATIONS

Authority to Enforce Conditions on the Approval of Deposit Insurance

Sec. ____. FEDERAL BANKING AGENCY AUTHORITY TO ENFORCE DEPOSIT INSURANCE CONDITIONS.

(a) Section 8 of the Federal Deposit Insurance Act (12 U.S.C. § 1818) is amended –

(1) in subsection (b)(1) in the first sentence, by striking "any condition imposed in writing by the agency" and inserting "any condition imposed in writing by a Federal banking agency";

(2) in subsection (e)(1)(A)(i)(III), by striking "any condition imposed in writing by the appropriate Federal banking agency" and inserting "any condition imposed in writing by a Federal banking agency"; and

(3) in subsection (i)(2)(A)(iii), by striking "any condition imposed in writing by the appropriate Federal banking agency" and inserting "any condition imposed in writing by a Federal banking agency".

Clarification of Section 8 Enforcement Actions that Change-in-Control Conditions are Enforceable

Sec.____. CLARIFICATION OF ENFORCEMENT AUTHORITY.

Section 8 of the Federal Deposit Insurance Act (12 U.S.C. 1818) is amended –

(a) in subsection (b)(1), in the first sentence, by striking "the granting of any application or other request by the depository institution" and inserting "any action on any application, notice, or other request by the depository institution or institution-affiliated party,";

(b) in subsection (e)(1)(A)(i)(III), striking "the grant of any application or other request by such depository institution" and inserting "any action on any application, notice, or request by such depository institution or institution-affiliated party"; and

(c) in subsection (i)(2)(A)(iii), by striking "the grant of any application or other request by such depository institution" and inserting "any action on any application, notice, or other request by the depository institution or institution-affiliated party".

<u>Deposit Insurance Related to the Optional Conversion of Federal Savings Associations</u>

Sec ____. CLARIFICATION OF APPLICATION REQUIREMENTS FOR OPTIONAL CONVERSION FOR FEDERAL SAVINGS ASSOCIATIONS.

(a) Paragraph 5 of the Home Owners' Loan Act (12 U.S.C. 1464(i)(5)) is amended to read as follows --

(5) CONVERSION TO NATIONAL OR STATE BANK. –

(A) IN GENERAL. – Any Federal savings association chartered and in operation before the date of the enactment of the Gramm-Leach-Bliley Act, with branches in operation before such date of enactment in 1 or more States, may convert, at its option, with the approval of the Comptroller of the Currency for each national bank, and with the approval of the appropriate State bank supervisor and the appropriate Federal banking agency for each State bank, into 1 or more national or State banks, each of which may encompass 1 or more of the branches of the Federal savings association in operation before such date of enactment in 1 or more States, but only if each resulting national or State bank (i) will meet all financial, management, and capital requirements applicable to the resulting national or State bank, and (ii) if more than 1 national or State bank results from a conversion under this subparagraph, has received approval from the Federal Deposit Insurance Corporation under section 5(a) of the Federal Deposit Insurance Act. No application under section 18(c) of the Federal Deposit Insurance Act shall be required for a conversion under this subparagraph.

(B) DEFINITIONS. – For purposes of this paragraph, the terms "State bank" and "State bank supervisor" have the meanings given those terms in section 3 of the Federal Deposit Insurance Act.".

(b) Section 4(c) of the Federal Deposit Insurance Act (12 U.S.C. § 1814(c)) is amended –

(1) after "Subject to section 5(d)", by inserting "of this Act and section 5(i)(5) of the Home Owners' Loan Act"; and

(2) in paragraph (2), after "insured State" by inserting "or Federal".

Bank Merger Act and Bank Holding Company Act

Bank Merger Act Amendment

Paragraph (5) of subsection (c) of section 18 of the FDI Act (12 U.S.C. § 1828(c)(5)) is amended -

> in the last sentence of paragraph (5), by inserting ", the potential risk of loss to the Bank Insurance Fund or Savings Association Insurance Fund" before ", and".

Bank Holding Company Act Amendment

Paragraph (2) of subsection (c) of section 3 of the Bank Holding Company Act (12 U.S.C. § 1842(c)(2)) is amended -

> by inserting ", the potential risk of loss to the Bank Insurance Fund or Savings Association Insurance Fund" before ", and".

Automatic Stay

Sec.____.AUTOMATIC STAY.

Section 11(d)(12) of the Federal Deposit Insurance Act (12 U.S.C. 1821(d)(12)) is amended to read as follows –

"(12) Automatic Stay. –

(A) In general. – Except as provided by paragraph (B), the appointment of a conservator or receiver for an insured depository institution operates as a stay applicable to all entities, of –

(i) the commencement or continuation, including the issuance or employment of process, of a judicial, administrative, or other action or proceeding against the conservator or receiver that was or could have been commenced before the appointment of the conservator or receiver;

(ii) the enforcement against the conservator or receiver or against property of the conservatorship or receivership estate, of a judgment obtained before the appointment of the conservator or receiver;

(iii) any act to obtain possession of property of the conservatorship or receivership estate or to exercise control over property of the conservatorship or receivership estate;

(iv) any act to create, perfect, or enforce any lien against property of the conservatorship or receivership estate;

(v) any act to create, perfect, or enforce against any property of the conservatorship or receivership estate any lien to the extent that such lien secures a claim that arose before the appointment of the conservator or receiver;

(vi) any act to collect, assess, or recover a claim against the conservator or receiver that arose before the appointment of the conservator or receiver.

(B) Exception. – The appointment of a conservator or receiver for an insured depository institution does not operate as a stay as to the rights of parties to certain qualified financial contracts pursuant to subsection (e)(8).

(C) Duration of Stay. – The stay shall be for a period not to exceed –

(i) 45 days, in the case of any conservator; and

(ii) 90 days, in the case of any receiver.".

National Flood Insurance Act and National Flood Disaster Protection Act Amendments

Sec. ___. AMENDMENTS TO THE NATIONAL FLOOD INSURANCE ACT OF 1968 AND THE FLOOD DISASTER PROTECTION ACT OF 1973.

(a) Section 1370(a) of the National Flood Insurance Act of 1968 (42 U.S.C. § 4121(a) is amended --

(1) by inserting in paragraph (9) "(in the case of a mortgage company that is a subsidiary of a financial holding company, the entity primarily responsible for supervision would be the Federal Trade Commission)" after "the supervision of the institution"; and

(2) by inserting in paragraph (13) "mortgage company that is a subsidiary of a financial holding company as defined by section 2(p) of the Bank Holding Company Act of 1956 (12 U.S.C. § 1841(p))," between "production credit association," and "or".

(b) Section 3(a) of the Flood Disaster Protection Act of 1973 (42 U.S.C. § 4003(a)) is amended --

(1) by inserting in paragraph (5) "(in the case of a mortgage company that is a subsidiary of a financial holding company, the entity primarily responsible for supervision would be the Federal Trade Commission)" after "the supervision of the institution"; and

(2) by inserting in paragraph (10) "mortgage company that is a subsidiary of a financial holding company as defined by section 2(p) of the Bank Holding Company Act of 1956 (12 U.S.C. § 1841(p))," between "production credit association," and "or".

(c) Section 102 of the Flood Disaster Protection Act of 1973 (42 U.S.C. § 4012a) is amended --

(1) by striking subsection (f);

(2) by redesignating subsections (g) and (h) as (f) and (g) respectively;

(3) by striking the current language of redesignated paragraph (f) and inserting the following:

"(f) Administrative enforcement.-

(1) Compliance with the requirements imposed under this chapter shall be enforced under

(A) section 8 of the Federal Deposit Insurance Act (12 U.S.C.§ 1818), in the case of –

(i) national banks, and Federal branches and Federal agencies of foreign banks, by the Office of the Comptroller of the Currency;

(ii) member banks of the Federal Reserve System (other than national banks), branches and agencies of foreign banks (other than Federal branches, Federal agencies, and insured State branches of foreign banks), commercial lending companies owned or controlled by foreign banks, and organizations operating under section 25 or 25(a) of the Federal Reserve Act (12 U.S.C. § 601 et seq., 611 et seq.), by the Board of Governors of the Federal Reserve System; and

(iii) banks insured by the Federal Deposit Insurance Corporation (other than members of the Federal Reserve System) and insured State branches of foreign banks, by the Board of Directors of the Federal Deposit Insurance Corporation;

(B) section 8 of the Federal Deposit Insurance Act (12 U.S.C. § 1818), by the Director of the Office of Thrift Supervision, in the case of a savings association the deposits of which are insured by the Federal Deposit Insurance Corporation;

(C) the Federal Credit Union Act (12 U.S.C. § 1751 et seq.), by the National Credit Union Administration Board with respect to any Federal credit union;

(D) the Farm Credit Act of 1971 (12 U.S.C. § 2001 et seq.) by the Farm Credit Administration with respect to any Federal land bank, Federal land bank association, Federal intermediate credit bank, or production credit association;

(E) the Federal Trade Commission Act (15 U.S.C. § 41 et seq.) by the Federal Trade Commission with respect to any mortgage company that is a subsidiary of a financial holding company; and

(F) the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (12 U.S.C. § 4501 et seq.) by the Office of Federal Housing Enterprise

Oversight with respect to any enterprise as that term is defined by 12 U.S.C. § 4502(6).

(2) For the purpose of the exercise by any agency referred to in paragraph (1) of this subsection of its powers under any Act referred to in that paragraph, a violation of any requirement imposed under this chapter shall be deemed to be a violation of a requirement imposed under that Act. In addition to its powers under any provision of law specifically referred to in paragraph (1) of this subsection, each of the agencies referred to in that paragraph may exercise, for the purpose of enforcing compliance with any requirement imposed under this chapter, any other authority conferred on it by law."

(4) by amending redesignated paragraph (g) so that it is titled, "Other actions to remedy noncompliance"; and

(5) by amending redesignated paragraph (g)(2)(A) by striking "engaged in a pattern and practice of noncompliance in violation of" and inserting "failed to comply with".

Acquisition of FICO Scores

Sec.____. ACQUISITION OF FICO SCORES.

Section 604(a) of the Fair Credit Reporting Act (15 U.S.C. 1681b(a)) is amended by adding a new paragraph after paragraph (5) as follows:

"(6) To the Federal Deposit Insurance Corporation as part of its preparation for its appointment or as part of its exercise of powers as conservator or receiver for an insured depository institution under the Federal Deposit Insurance Act or other applicable Federal or State law or in connection with the resolution or liquidation of a failed or failing insured depository institution .".

Resolution of Deposit Insurance Disputes

Sec.____. RESOLUTION OF DEPOSIT INSURANCE DISPUTES.

Paragraphs (3), (4), and (5) of section 11(f) of the Federal Deposit Insurance Act (12 U.S.C. § 1821(f)(3)) are amended to read as follows:

"(3) RESOLUTION OF DISPUTES. -- The Corporation's determination regarding any claim for insurance coverage shall be treated as a final determination for purposes of this section. In its discretion, the Corporation may promulgate regulations prescribing procedures for

resolving any disputed claim relating to any insured deposit or any determination of insurance coverage with respect to any deposit.

(4) REVIEW OF CORPORATION'S DETERMINATION. -- A final determination made by the Corporation shall be a final agency action reviewable in accordance with chapter 7 of title 5, United States Code, by the United States district court for the Federal judicial district where the principal place of business of the depository institution is located.

(5) STATUTE OF LIMITATIONS. – Any request for review of a final determination by the Corporation shall be filed with the appropriate United States district court not later than 60 days after such determination is issued.".

Amendment to Exclude Advisory Committees to the Banking Agencies from the Federal Advisory Committee Act

Sec.____. EXEMPTION FROM THE FEDERAL ADVISORY COMMITTEE ACT.

The Federal Deposit Insurance Act (12 U.S.C. 1811 et seq.) is amended by adding at the end the following new section:

"Sec. _____ . ADVISORY COMMITTEES ESTABLISHED BY THE FEDERAL BANKING AGENCIES.—

(a) IN GENERAL.-- The Comptroller of the Currency, the Federal Deposit Insurance Corporation, and the Office of Thrift Supervision may each establish and use a committee composed of persons selected by the agency to provide advice and recommendations to the agency relating to safety and soundness, product and service developments and delivery, or consumer issues affecting the institutions supervised by such agencies, and, with respect to committees formed by the Federal Deposit Insurance Corporation, the protection, operation, and administration of the deposit insurance funds, including the resolution and liquidation of failed or failing insured depository institutions.

(b) EQUAL TREATMENT.--Notwithstanding any other law, a Federal banking agency that establishes and uses an advisory committee under subsection (a) shall be treated in the same manner as if it were the Federal Reserve System establishing and using the advisory committee.".

NASCUS

Testimony of Jerrie J. Lattimore
Administrator, Credit Union Division
North Carolina
on behalf of the
National Association of State Credit Union Supervisors
before the
Subcommittee on Financial Institutions and Consumer Credit
House Financial Services Committee
March 27, 2003

NASCUS History and Purpose

Mr. Chairman and members of the Subcommittee, My name is Jerrie Jay Lattimore. I am the North Carolina regulator for state-chartered credit unions and Chairman of the National Association of State Credit Union Supervisors (NASCUS). I was appointed by then Governor Jim Hunt as the North Carolina regulator seven years ago, and prior to that, served as Assistant General Counsel for NationsBank, now Bank of America.

NASCUS has been in existence since 1965 and represents all 48 state and territorial credit union supervisors who regulate more than 4,300 state-chartered credit unions, almost 50% of all credit unions in the United States. In addition, our Credit Union Council membership consists of nearly 800 CEOs of state-chartered credit unions that have a keen interest in protecting and enhancing the dual system for chartering and supervising credit unions.

Like my 47 counterparts in state government, the North Carolina Credit Union Division is committed to carrying out its mission through efficient and effective chartering, regulation and supervision of state-chartered credit unions within the statutory requirements and prudent industry safety and soundness standards. We serve the public through responsible regulation, effective administration and the vigorous enforcement of state laws and many federal laws as well.

Provisions of the Bill Affecting Federal Credit Unions and Other Institutions

NASCUS is supportive of your efforts to reduce the regulatory burden on all depository institutions and I appear, today, to comment on those aspects of H.R. 1375, The Financial Services Regulatory Relief Act of 2003 that directly impact the state credit union system.

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NASCUS endorses your efforts to reduce regulatory burdens on financial institutions and, in general, supports the statutory improvements that this legislation would provide for federally chartered credit unions. We believe that a viable and healthy dual chartering system requires that the charter for federal credit unions should be modernized to meet competitive demands and credit union member needs.

Our specific testimony on this legislation addresses the issues in the pending regulatory relief legislation that would directly impact state-chartered and regulated credit unions. NASCUS, also, would suggest some further revisions to the Federal Credit Union Act that would strengthen the state credit union charter. All of these recommendations to the Committee were outlined in our letter to Chairman Oxley dated January 23, 2003.

Specific Provisions Affecting State-Chartered Credit Unions

There are two provisions contained in the regulatory relief bill that NASCUS would like to address today. The first provision would authorize state-chartered privately-insured credit unions to be eligible for membership in the Federal Home Loan Banks.

NASCUS strongly supports the provisions contained in the regulatory relief legislation that would authorize state-chartered privately insured credit unions to be eligible for membership in the Federal Home Loan Banks.

Today, there are approximately 365 credit unions that are non-federally insured. All of these credit unions are regulated and examined by agencies of state governments to ensure that they are operating in a safe and sound manner. Sound management and effective regulatory oversight are the primary determinant of the safety and soundness of a credit union.

To protect credit union members, both federal and private share insurance systems have been established. To manage and price insurance risk, each share insurer relies significantly on the examination reports of the institution's primary regulator. In the case of state chartered credit unions, that supervision and examination function is performed by the state credit union regulator. Privately insured state-chartered credit unions are examined by their primary safety and soundness regulator, the state credit union supervisor, in exactly the same manner as federally insured state-chartered credit unions.

In short, privately insured credit unions and federally insured credit unions are required to meet and maintain the same standards of financial performance by state regulators.

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With regard to privately insured credit unions, it is important to note that the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA) established a series of safety and soundness requirements both for entities that would offer private deposit insurance to credit unions and for credit unions which would opt for private deposit insurance.

FDICIA also requires that privately insured credit unions must be certified to meet eligibility requirements for federal deposit insurance. Specifically, the Act states that no depository institution which lacks federal deposit insurance may use "the mails or any instrumentality of interstate commerce to receive or facilitate receiving deposits, *unless* the appropriate supervisor of the State in which the institution is chartered has determined that the institution meets all eligibility requirements for Federal deposit insurance..." (Emphasis added). As a practical matter, this requirement applies to every state-chartered privately insured credit union, as every such credit union uses some instrumentality of interstate commerce or the mails.

FDICIA also spells out the manner and extent to which institutions opting for private deposit insurance are required to fully disclose that their deposits are privately insured.

NASCUS is aware that the Appropriations Committees have not provided funding to the Federal Trade Commission for these purposes and the last appropriations legislation directed the General Accounting Office (GAO) to determine which agency should enforce these private insurance disclosure requirements of FDICIA. That report from the GAO was directed by Congress to be completed within six months. So, the issue of consumer disclosure enforcement for private share insurance should be resolved shortly.

Permitting non-federally insured institutions to join the FHLBank System would not establish a new membership principle for the System. Insurance companies, chartered and regulated by state governments, are eligible to be members of these Banks. At the end of last September the number of non-federally insured state regulated insurance company members had grown to more than 70.

Thus, allowing FHLBank membership for these credit unions that wish to expand housing finance opportunities for their members would not subject the FHLBank System to any new or unusual financial risk or exposure. Each Federal Home Loan Bank has a sophisticated credit screening system to assure that any borrower, federally insured or not, is "credit worthy." In addition, every advance is fully secured by marketable collateral. Indeed, we understand that no Federal Home Loan Bank has suffered a loss on advances extended to their members.

In the past, Congress has expanded the membership eligibility for the Bank System as a mechanism to help local financial institutions meet the housing and home ownership needs of their communities. The inclusion of this provision, enabling state-chartered, privately insured

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credit unions to be eligible to join the FHLBank System, is merely one more step in bringing additional home ownership opportunities to these credit union members.

We urge the Committee to approve this provision in the bill that would help achieve our nation's housing and home ownership goals.

Exemptions from Broker-Dealer Registration Rules

Another provision of the regulatory relief package would give federally insured credit unions and savings institutions "parity of treatment" with commercial banks with regard to exemptions from SEC registration requirements that banks were provided by the Gramm-Leach-Bliley Act.

NASCUS supports provisions that would permit state-chartered credit unions to be accorded similar regulatory relief treatment. We understand that the NCUA has endorsed provisions of this bill that would grant this parity of treatment to all federal and state, federally insured credit unions and has previously submitted language to the Committee to achieve these purposes.

Our major concern is that, unless state-chartered credit unions, both federally-insured and privately insured, are accorded the same SEC treatment as commercial banks and savings institutions, the powers granted credit unions by state legislatures and by state regulators will be unnecessarily preempted by SEC regulation. Unless appropriate regulatory relief is provided, credit unions offering these services may be subject to redundant and costly examination and oversight.

It should be clearly understood that this proposed provision specifically extends only to those activities that state-chartered credit unions are authorized to engage in under relevant chartering statutes and does not create any new powers for state-chartered credit unions.

Other NASCUS Legislative Priorities

There are two other legislative issues that NASCUS would like the Committee to address.

The first is relief from restrictive member business loan constraints that were added by the Senate to the Credit Union Membership Access Act of 1998.

The second is to permit credit unions to count supplemental capital as a part of the "net worth" definition included in the Federal Credit Union Act for PCA purposes.

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Revising Member Business Lending Restrictions in the Federal Credit Union Act

Historically, many credit unions have provided members with loans for business purposes. In recent years, particularly during the consolidation of the banking industry, credit union members have sought small business financing from their credit unions. Member business lending by community based institutions, credit unions in this case, not only meets the credit needs of members but also serves as a valuable source of financing for community development and local job creation. Credit unions are not in the business of lending to foreign corporations or governments. Their business loans are made locally and the funds recycle throughout the local community. At a time when small businesses are closing and jobs are being lost in many local communities, permitting credit unions greater flexibility to help meet local small business lending needs of their members would be sound public policy.

Until the Credit Union Membership Access Act was enacted by Congress in 1998, the authority of state-chartered credit unions to engage in business lending to their members was a matter to be determined by state statute and regulation. That Act imposed a severe limit on the member business lending activities of all federally insured credit unions, whether chartered and regulated by the States or by the National Credit Union Administration. That restriction on state chartered credit unions was not contained in the House version of the bill. It was added by the Senate Banking Committee and the House later accepted the Senate version of the bill. In short, there was no opportunity to eliminate, or even reach a workable compromise, on this new restriction on state credit union powers through a Conference Committee process.

NASCUS would urge, as a matter of principle, that the restrictions on member business lending be removed from the Federal Credit Union Act and, for state-chartered credit unions and returned to the State legislatures and credit union supervisors to regulate.

If that solution is not acceptable to the Committee, then NASCUS would urge that credit unions be granted business lending authority substantially equivalent to that proposed for federal savings institutions in this bill.

Last year, during the markup of the predecessor regulatory relief bill, federal savings institutions, without dissent, were granted a substantial expansion of business lending authority by this Committee. That bill eliminated any limitation on small business loans (those, we understand, of $1M or less in size) and an increase in the limit on larger business loans from 10% to 20% of assets for federally chartered savings associations.

NASCUS has raised no objections to this expansion of business lending powers for the savings institution industry. That industry understands the additional powers they require to remain competitive in the marketplace.

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NASCUS would propose to the Committee a two step legislative solution that would provide credit unions with roughly equivalent regulatory relief in the business lending area.

First, the asset limitation contained in the Federal Credit Union Act for credit union member business loans should be raised from 12.25% to the same percentage, 20%, as proposed for federal saving associations. Secondly, "micro" member business loans, those of less than the Fannie Mae/Freddie Mac ceiling (roughly $322,000), should be excluded from the member business loan cap of each federally insured credit union.

In fairness, the reform of business lending authority for the savings and loan industry and credit union community should be authorized by simultaneous and comparable federal legislative relief.

Supplemental Capital Authority for Credit Unions

The combination of PCA requirements established by Congress for credit unions in 1998 and subsequent rapid deposit growth has created a financial and regulatory dilemma for many state-chartered credit unions. The Federal Credit Union Act defines credit union "net worth "as retained earnings. The NCUA has determined that they do not have the regulatory authority to broaden that "net worth" definition in the Federal Credit Union Act to include credit union supplemental capital as a part of PCA calculations. Thus, credit unions will require an amendment to The Federal Credit Union Act to rectify this statutory deficiency.

To continue to meet the financial needs of their members for additional services such as financing home ownership and providing financial education and credit counseling, many state chartered credit unions will not be able to rely, solely, on retained earnings to meet the capital base required by PCA standards.

As a result of the flight to financial safety by their members, many credit unions have rapidly growing "deposit" bases and face the following strategic choices:

- Constrict membership service (and growth) and live with capital generated from current earnings, the only source of capital, currently, for most credit unions to meet PCA requirements (apply growth constraints because supplemental capital sources are not available).
- Convert to a stock form of a depository institution. (Twenty-one credit unions have converted to other charters in recent years). We would argue that there should be no need to give up the credit union charter to gain access to additional capital. All other types of depository institutions have supplemental forms of capital available.

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- Remain a credit union and raise supplemental or alternative capital from either members or external sources. (as corporate credit unions and low-income credit unions are now permitted to do by the Federal Credit Union Act). However, for most credit unions, this remedy would require an amendment to the Federal Credit Union Act since the NCUA has determined that they cannot include supplemental capital in "net worth" for PCA purposes without specific statutory language broadening the definition of credit union "net worth"

With the economic downturn and the flight to safety from the stock market, credit union member savings are growing rapidly and many credit unions are showing reduced "net worth" ratios.

As a regulator, it makes no business sense to deny credit unions the use of other forms of capital that improve their safety and soundness. We should take every financially feasible step to strengthen the capital base of this nation's credit union system.

Representatives Brad Sherman (CA) and Robert Ney (OH) introduced amendments to the regulatory relief bill in the last Congress to expand the definition of "net worth" in the Federal Credit Union Act. However, these amendments were withdrawn since they were opposed by other segments of the depository institution community and the Committee had held no hearings on this issue.

Recently, the Filene Research Institute published a study on the feasibility of allowing credit unions to count subordinated debt toward their federal PCA capital requirements. The study was prepared by Professor James A. Wilcox of the Haas School of Business, University of California-Berkeley. His conclusion was that permitting credit unions to issue subordinate debt, (as many state statutes now permit), and count it as a part of "net worth" would be beneficial for credit unions and would achieve important public policy objectives.

As Committee members may be aware, Dr. Wilcox was chief economist for the Office of the Comptroller of the Currency, senior economist for the President's Council of Economic Advisors and an economist for the Federal Reserve. The study is lengthy and detailed and I will not submit it for the record, but will make copies available for the Committee staff and any Members who would like a copy.

NASCUS understands that permitting supplemental capital to be counted as a part of "net worth" for PCA purposes for federally insured credit unions may be beyond the scope of this regulatory relief package. However, we would urge that this Committee consider and approve this revision of the definition of "net worth" for credit unions when other omnibus financial institutions legislation is considered by this Committee later in this Congress.

GAO Study of Credit Union Safety and Soundness and Regulatory Structure

Last August, as this Committee may be aware, the Senate Banking Committee requested that the General Accounting Office undertake a study of credit union safety and soundness and the organization and structure of regulation and supervision by the NCUA and State regulatory agencies. The last major review by GAO of the credit union industry and regulatory structure was in 1991. State credit union regulators welcome the opportunity to inform and educate GAO staff about the major improvements in supervision and regulation undertaken by States since the 1991 study. NASCUS has held three meetings with GAO staff to provide them with information about the state segment of the credit union system and GAO staff have held telephone or "in person" meetings with State credit union regulators.

Unfortunately, the letter to the GAO from the Chairman of the Senate Banking Committee describing the purposes of this study has not been made public. In short, even though state regulators are being interviewed and asked to fill out surveys from the GAO, they do not know the exact purpose and scope of this GAO study. NASCUS hopes that this Committee will provide them with a copy of the letter request to the GAO from the Congress.

Without the benefit of a full description of the scope of this congressionally mandated study, NASCUS assumes that the GAO will evaluate the performance and structure of the NCUA as the 1991 study did. We assume that the GAO will evaluate the responsibilities of NCUA for supervising and regulating federal credit unions and providing share insurance to both federal and state-chartered and regulated credit unions.

When the GAO study is completed and oversight hearings are held by the Congress, NASCUS may wish to submit recommendations to this Committee for changes in the organization and structure of NCUA to delineate, clearly, the two functions NCUA performs; first, the regulatory agency for federal credit unions; and secondly, the federal insurance agency for both federal and state chartered credit unions.

Safety and Soundness of State Credit Union Sector

NASCUS regularly reviews key financial performance characteristics of the federally chartered and state-chartered credit unions. The current data indicates that, in every essential safety and soundness category, the financial performance of state-chartered credit unions is as sound as that of federally chartered institutions. The current key indicators of financial health for the two sectors of the industry show the following.

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At the end of 2002:

- The capital ratio of federal credit unions was 11.48%.
- The capital ratio of state-chartered credit unions was 11.27%.

In short, their capital ratios were roughly the same.

- The Return on Average Assets (ROAA) for federal credit unions was 1.08%.
- The ROAA for state-chartered, credit unions was 1.06%.

In short, their ROAA ratios were roughly the same.

Finally, the data demonstrates that all of the major asset quality indicators for these two groups of credit unions are roughly the same.

Moreover, the recent expansion of fields of membership for both federal and state-chartered credit unions has diversified geographical risks for many credit unions, enhancing the safety and soundness of these institutions. Credit unions with more diversified membership bases are growing more rapidly than credit unions with narrow fields of membership, often tied to employees of a single or a few local employers, and this diversification results in a stronger and safer system.

We should not forget some important lessons of commercial banking history. As financial analysts have pointed out, most of the commercial bank failures in the 1920's and 1930's occurred in "unit" banking states where commercial banks were not permitted to diversify geographically and were "prisoners" of the local economy. As a result, many of these banks with highly restrictive customer bases failed because their safety and soundness was severely impacted by the economic misfortunes of their local economies while banks with more diversified customer bases survived and thrived.

By enacting the Reigle-Neal Act in the 1995, Congress recognized that permitting geographic diversification of the customer bases for banks would improve the safety and soundness of the commercial banking system

In the state-chartered credit union system, which began in the early 1900s, state legislatures were in the forefront in permitting credit unions to diversify their fields of membership. "Community" was the original basis for credit union membership. Today, regulators at both the federal and state level understand that there is "safety and soundness value" in diverse fields of membership for credit unions.

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Conclusion

NASCUS appreciates this opportunity to testify today on the pending regulatory relief legislation. We urge this Committee to protect and enhance the viability of the dual chartering system for credit unions by acting favorably on the provisions we have discussed in our testimony.

The NASCUS mission is to enhance state credit union supervision and advocate a safe and sound state credit union system. Founded in 1965, NASCUS represents all 48 state and territorial credit union supervisors and the NASCUS Credit Union Council, which is made up of nearly 800 of the nation's more than 4,300 state-chartered credit unions.

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Statement of

Mark W. Olson

Member

Board of Governors of the Federal Reserve System

before the

Subcommittee on Financial Institutions and Consumer Credit

of the

Committee on Financial Services

House of Representatives

March 27, 2003

Mr. Chairman and members of the subcommittee, thank you for the opportunity to testify on the Financial Services Regulatory Relief Act of 2003. The Federal Reserve supports the efforts of the committee to periodically review the federal banking laws to determine whether they may be streamlined without sacrificing the safety and soundness of this nation's insured depository institutions. I know from personal experience that developing regulatory relief legislation that appropriately balances burden reduction and sound public policy is no easy task, and I commend the committee for again addressing the issue of regulatory relief.

Earlier this year, Chairman Oxley asked the Federal Reserve and the other federal banking agencies for suggestions on how to improve the banking laws and relieve unnecessary burden. I am pleased to note that some of our suggestions--including those authorizing depository institutions to pay interest on demand deposits, permitting the Federal Reserve to pay interest on balances held at Reserve Banks, and enhancing the Board's flexibility to set reserve requirements--recently were passed by the full committee as part of H.R. 758, the Business Checking Freedom Act of 2003. Many of our other suggestions have been incorporated into this bill. Before I review the most important of these provisions, let me note that we would be happy to continue to work with the subcommittee and the full committee and their staffs as the bill moves forward. The bill includes provisions that should enhance the efficiency of the banking industry and benefit consumers.

De novo interstate branching

Both the Federal Reserve and the Office of the Comptroller of the Currency recommend that Congress remove outdated barriers to de novo interstate branching. Since enactment of the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994, all fifty states have permitted banks to expand on an interstate basis through the acquisition of another bank. As a

result, interstate branching is a reality. And it is a reality with good results: commercial banks currently operate more than 67,000 branches in the United States, an amount that far exceeds the 51,000 branches operated by banks in 1990. More than 1,700 branches were opened by banks in 2002 alone. The creation of new branches helps maintain the competitiveness and dynamism of the American banking industry and improve access to banking services in otherwise under-served markets. Branch entry into new markets leads to less concentration in local banking markets, which, in turn, results in better banking services for households and small businesses, lower interest rates on loans and higher interest rates on deposits. As customers become more mobile and live, work and operate across state borders, they also benefit from allowing banks to operate branches across state lines.

However, the Riegle-Neal Act permitted banks to open a branch in a new state *without* acquiring another bank only if the host state enacted legislation that expressly permits entry by de novo branching (an "opt-in" requirement). To date, seventeen states have enacted some form of opt-in legislation, and thirty-three states and the District of Columbia continue to require interstate entry through the acquisition of an existing bank.

This limitation on de novo branching is an obstacle to interstate entry for all banks and also creates special problems for small banks seeking to operate across state lines. Moreover, it creates an unlevel playing field between banks and federal savings associations, which have long been allowed to establish de novo branches on an interstate basis.

The Financial Services Regulatory Relief Act of 2003 would remove this last obstacle to interstate branching for all banks and level the playing field between banks and thrifts by allowing banks to establish interstate branches on a de novo basis. The bill also would remove the parallel provision that allows states to impose a minimum requirement on the age of banks

that are acquired by an out-of-state banking organization. These changes would allow banks, including in particular small banks near state borders, to better serve their customers by establishing new interstate branches and acquiring newly chartered banks across state lines. It also would increase competition by providing banks a less costly method for offering their services at new locations. The establishment and operation of any new interstate branches would continue to be subject to the other regulatory provisions and conditions established by Congress for de novo interstate branches, including the financial, managerial, and Community Reinvestment Act requirements set forth in the Riegle-Neal Act.

While we support the bill's provisions expanding the de novo branching authority of banks, we continue to believe that Congress should not grant this new branching authority to industrial loan companies (ILCs) unless the owners of these institutions are subject to the same type of consolidated supervision and activities restrictions as the owners of other insured banks. ILCs are FDIC-insured banks that operate under a special exemption from the Bank Holding Company Act (BHC Act). This exemption allows a commercial company to own an ILC without being subject to the supervisory requirements and activities limitations generally applicable to the corporate owners of other insured banks. The bill as currently drafted would allow large retail companies to establish an ILC and then open a branch of the bank in each of the company's retail stores nationwide. Allowing a commercial firm to operate a nationwide bank outside the supervisory framework established by Congress for the owners of insured banks raises significant safety and soundness concerns and creates an unlevel competitive playing field. In addition, permitting commercial firms to control a nationwide bank would undermine this nation's policy of maintaining the separation of banking and commerce--a policy recently reaffirmed by the Congress in the Gramm-Leach-Bliley Act (GLB Act).

Reduction of cross-marketing restrictions

Another important provision of the bill amends the cross-marketing restrictions imposed by the GLB Act on the merchant banking investments of financial holding companies. Currently, a depository institution controlled by a financial holding company may not engage in cross-marketing activities with a nonfinancial company owned by the same financial holding company under the GLB Act's merchant banking authority. This restriction was intended to help preserve the separation between the financial holding company's depository institutions on the one hand, and the nonfinancial portfolio company on the other hand.

The GLB Act, however, already permits a depository institution subsidiary of a financial holding company to engage in cross-marketing activities through statement stuffers and Internet websites with nonfinancial companies held by an insurance underwriting affiliate under the parallel insurance company investment authority granted by the GLB Act. These cross-marketing activities are permitted only if they are conducted in accordance with the anti-tying restrictions of the Bank Holding Company Act Amendments of 1970 and the Board determines that the proposed arrangement is in the public interest, does not undermine the separation of banking and commerce, and is consistent with the safety and soundness of depository institutions.

The bill would allow depository institutions controlled by a financial holding company to engage in cross-marketing activities with companies held under the merchant banking authority to the same extent, and subject to the same restrictions, as companies held under the insurance company investment authority. We believe that this parity of treatment is appropriate, and see no reason to treat the merchant banking and insurance investments of financial holding companies differently for purposes of the cross-marketing restrictions of the GLB Act.

The bill also would permit a depository institution subsidiary of a financial holding company to engage in cross-marketing activities with a nonfinancial company held under the merchant banking authority if the nonfinancial company is not controlled by the financial holding company. When a financial holding company does not control a portfolio company, cross-marketing activities are unlikely to materially undermine the separation between the nonfinancial portfolio company and the financial holding company's depository institution subsidiaries. In these noncontrol situations, we believe the separation of banking and commerce is maintained adequately by the other restrictions contained in the GLB Act that limit the holding period of the investment as well as the authority of the financial holding company to routinely manage and operate the portfolio company.

Shortening the post-approval waiting period for bank acquisitions and mergers

Currently, banks and bank holding companies are required by statute to delay consummation of a proposal to merge with or acquire another bank or bank holding company for thirty days after the date the transaction is approved by the appropriate federal banking agency. This statutory delay is designed to allow the U.S. Attorney General an opportunity to initiate legal action if the Attorney General believes the transaction will have a significantly adverse effect on competition.

The Bank Holding Company Act and the Bank Merger Act allow this post-approval waiting period to be shortened to fifteen days if the relevant federal banking agency and the U.S. Attorney General concur. However, those acts do not permit the agencies to shorten the period to less than fifteen days, even in cases in which the relevant federal banking agency and the Attorney General agree that the transaction will not have an adverse effect on competition.

The bill would allow the appropriate federal banking agency and the Attorney General to jointly reduce this waiting period to five days if both agencies determine that the proposal would not result in significantly adverse effects on competition in any relevant market. This revision would allow the parties to an approved bank merger or acquisition to more quickly consummate their transaction and seek to achieve any resulting economies of scale or efficiencies. Importantly, the amendment would not shorten the time period that private parties have to challenge the appropriate banking agency's approval of the transaction under the Community Reinvestment Act. In addition, a mandatory thirty-day waiting period would continue to be required for any transaction unless the Attorney General agreed to a shorter period (other than in cases involving a bank failure or an emergency, for which the statutes already set different periods).

Eliminate certain unnecessary reports

Another provision in the bill would eliminate certain reporting requirements that currently are imposed by statute on banks and their executive officers and principal shareholders. In particular, the bill repeals three reporting provisions. The first requires any executive officer of a bank to file a report with the bank's board of directors whenever the executive officer obtains a loan *from another bank* in an amount that exceeds the amount the executive officer could obtain from his or her own bank. The second provision requires a bank to file a separate report with its quarterly call report regarding any loans the bank has made to its executive officers during the current quarter. The third reporting provision requires the executive officers and principal shareholders of a bank to file an annual report with the bank's board of directors if the officer or shareholder has any loan outstanding from a *correspondent bank* of the bank. This provision also authorizes the federal banking agencies to

issue rules requiring a bank to publicly disclose information received from an executive officer or principal shareholder concerning his or her loans from a correspondent bank.

These three reporting requirements are of limited usefulness and the Board has not found that they contribute significantly to the effective monitoring of insider lending or the prevention of insider abuse. Based on our supervisory experience, we believe the costs of preparing and collecting these reports outweigh their benefits. Accordingly, we view them as precisely the type of requirements that should be eliminated in a regulatory relief bill.

Moreover, elimination of these reporting requirements would not alter the statutory restrictions on loans by banks to their executive officers and principal shareholders, or limit the authority of the federal banking agencies to take enforcement action against a bank or its insiders for violation of these statutory lending limits. In addition, the Board's Regulation O already requires that depository institutions and their insiders maintain sufficient information to enable examiners to monitor the institution's compliance with the federal banking laws regulating insider lending, and each federal banking agency also would retain authority under other provisions of law to collect information regarding insider lending.

Update exception allowing interlocks with small depository institutions

The bill also would update an exception already granted by statute under the Depository Institutions Management Interlocks Act. That act generally prohibits depository organizations that are not affiliated with each other from having management officials in common if the organizations are located or have a depository institution affiliate located in the same metropolitan statistical area (MSA), primary metropolitan statistical area, or consolidated

metropolitan statistical area. The Act provides some modest leeway for interlocks with a depository institution that has less than $20 million in assets.

This exception for small institutions was established in 1978 in recognition of the special hardships that small institutions face in attracting and retaining qualified management. The asset limit embodied in the exception, however, has not been increased since 1978 despite inflation and the growth in the average size of depository institutions. Accordingly, the bill would amend the exception to cover organizations with less than $100 million in assets that are located in an MSA. This change would conform the asset limit for small institution director interlocks with the exception already provided by statute for advisory and honorary director interlocks.

Permit the Board to grant exceptions to attribution rule

The bill also contains a provision that we believe will help banking organizations maintain attractive benefits programs for their employees. The BHC Act generally prohibits a bank holding company from owning, in the aggregate, more than 5 percent of the voting shares of any company without the Board's approval. The BHC Act also provides that any shares held by a trust for the benefit of a bank holding company or its shareholders, members or employees are deemed to be controlled by the holding company. This attribution rule was intended to prevent a bank holding company from using a trust established for the benefit of its management, shareholders or employees to evade the BHC Act's restrictions on the acquisition of shares of banks and nonbanking companies.

While this attribution rule generally is a useful tool in preventing evasions of the BHC Act, it does not always provide an appropriate result. For example, it may not be appropriate to apply the attribution rule when shares are acquired by a retirement trust, 401(k) plan or

profit-sharing plan that operates for the benefit of employees of the bank holding company. In these situations, the bank holding company may not have the ability to influence the purchase or sale decisions of the employees or otherwise control shares that are held in trust for its employees. The bill would allow the Board to address these situations by authorizing the Board to grant exceptions from the attribution rule where appropriate.

Conclusion

The bill includes certain other provisions suggested by the Federal Reserve, including useful clarifications of the ability of insured banks to acquire savings associations in interstate merger transactions and of the authority of the federal banking agencies to maintain the confidentiality of supervisory information obtained from foreign supervisory authorities. My colleagues at the other federal banking agencies also have made numerous suggestions that you will hear about this morning. I appreciate the opportunity to speak about the Board's legislative suggestions, and I look forward to working with both the subcommittee and the full committee on this legislation.

For Release Upon Delivery
9:30 a.m., March 27, 2003

TESTIMONY OF

JULIE L. WILLIAMS

FIRST SENIOR DEPUTY COMPTROLLER AND CHIEF COUNSEL

OFFICE OF THE COMPTROLLER OF THE CURRENCY

Before the

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

of the

COMMITTEE ON FINANCIAL SERVICES

of the

U. S. HOUSE OF REPRESENTATIVES

March 27, 2003

Statement required by 12 U.S.C. 250:

The views expressed herein are those of the Office of the Comptroller of the Currency and do not necessarily represent the views of the President.

Introduction

Chairman Bachus, Ranking Member Sanders, and members of the Subcommittee, I appreciate this opportunity to appear before you again to discuss with you ways in which we can reduce unnecessary regulatory burden on America's banking system, and to express the views of the Office of the Comptroller of the Currency (OCC) on H.R. 1375, the Financial Services Regulatory Relief Act of 2003 (FSRR Act). Let me also thank Congresswoman Capito, for again sponsoring a bill that includes sensible and appropriate regulatory burden relief for national banks and other financial institutions.

Many of the provisions in the FSRR Act were also in H.R. 3951, the financial services regulatory relief legislation which was prepared for Floor action in the House last year after being reported by the Committee on Financial Services. I want to thank the Committee for including almost all of the items suggested by the OCC in these bills. In addition to the provisions that were in H.R. 3951, the FSRR Act also includes some important new amendments that will advance the goal of reducing unnecessary burdens and costs on our nation's banks.

Effective bank supervision demands that regulators achieve a balance between promoting and maintaining the safety and soundness of the banking system and fostering banks' ability to conduct their business profitably and competitively. This is only possible if banks are free from burdensome constraints that are not necessary to further the purposes of the banking laws or to protect safety and soundness. Unnecessary burdens drive up the costs of doing business for banks and their customers and prevent banks from effectively serving the public. Periodic review of the banking statutes and regulations is an essential means of ensuring that banks are not needlessly encumbered by requirements that are no longer appropriate for today's banking environment.

The OCC has a continuing commitment to review its regulations and make changes, consistent with safety and soundness, to enable banks to keep pace with product innovation, new technologies, and changing consumer demand. We constantly reassess the effectiveness and efficiency of our supervisory processes to focus our efforts on the institutions and activities that present the greatest risks, and to reduce unnecessary burdens on demonstrably well-run banks. An exciting new development in this regard is the OCC's new "E-corp" system, which enables national banks to file their corporate applications electronically. Using National BankNet, the OCC's internet-based system for national banks, national banks can now file new branch and branch relocation applications electronically. We will be adding more applications to the system on a rolling basis.

In addition, we also are currently working with the other banking agencies to prepare for the regulatory review required under section 2222 of the Economic Growth and Regulatory Paperwork Reduction Act of 1996. Section 2222 requires the Federal Financial Institutions Examination Council and each Federal banking agency to conduct a review of all regulations every 10 years to identify outdated, unnecessary regulatory requirements. We and the other Federal banking agencies have identified our teams for this project and our work is already underway.

However, the results that Congress can achieve today by removing or reducing regulatory burden imposed by Federal statutes can be broader and more far-reaching than regulatory changes that we can make under the current law. The FSRR Act contains a number of important provisions that will help banks remain profitable and competitive by eliminating unnecessary burden. My testimony will highlight several of these provisions.[1]

The FSRR Act also contains provisions that further our ability to promote and maintain the safety and soundness of the banking system. I will mention a few of these provisions in my testimony. I will also take this opportunity to briefly discuss our suggestions to improve some of the provisions in the FSRR Act and our recommendations for additional changes that you may wish to consider as the legislation advances.

National Bank Provisions

The FSRR Act contains several provisions that would streamline and modernize aspects of the corporate governance and interstate operations of national banks. The OCC strongly supports these provisions.

For example, section 101 of the Act relieves a restriction in current law that impedes the ability of national banks to operate as "Subchapter S" corporations. The National Bank Act currently requires all directors of a national bank to own at least $1,000 worth of shares of that bank or an equivalent interest in a bank holding company that controls the bank. The requirement means that all directors must be shareholders, making it difficult or impossible for some banks to comply with the 75-shareholder limit that defines eligibility for treatment as a Subchapter S corporation. These banks are thus ineligible for the benefit of Subchapter S tax treatment, which avoids a double tax on the bank's earnings. Community banks suffer most from this result.

Section 101 authorizes the Comptroller to permit the directors of banks seeking Subchapter S status to satisfy the qualifying shares requirement by holding a debt instrument that is subordinated to the amounts owed by the bank to its depositors and general creditors. The holding of such an instrument would not cause a director to be counted as a shareholder for purposes of Subchapter S. The subordinated liability has features resembling an equity interest, however, since the directors could only be repaid if all other claims of depositors and nondeposit general creditors of the bank were first paid in full, including the claims of the FDIC, if any. The new requirement would thus ensure that directors retain the requisite personal stake in the financial soundness of their bank, but yet would allow the bank to take advantage of Subchapter S tax treatment.

Similarly, section 102 of the Act eliminates a requirement in current law that precludes a national bank from prescribing, in its articles of association, the method for election of directors that best suits its business goals and needs. Unlike most other companies and state banks, national banks cannot choose whether or not to permit cumulative voting in the

[1] A detailed section-by-section review of the provisions of Title I, IV, and VI of the FSRR Act that are relevant to the OCC's responsibilities is attached to this testimony as an appendix.

election of their directors. Instead, current law requires a national bank to permit its shareholders to vote their shares cumulatively. Section 102 provides that a national bank's articles of association may permit cumulative voting. This amendment would conform the National Bank Act to modern corporate codes and provide national banks with the same corporate flexibility available to most corporations and state banks.

An important new provision that was added to FSRR Act is section 110. This provision is strongly supported by the OCC and clarifies that the OCC may permit a national bank to organize in any business form, in addition to a "body corporate." An example of an alternative form of organization would be a limited liability national association, comparable to a limited liability company. The provision also clarifies that the OCC's rules will provide the organizational characteristics of a national bank operating in an alternative form, consistent with safety and soundness. Except as provided by these organizational characteristics, all national banks, notwithstanding their form of organization, will have the same rights and privileges and be subject to the same restrictions and enforcement authority.

Allowing a national bank to choose the business form that is most consistent with the banks' business plans improves the efficiency of a national bank's operations. For example, if the OCC should permit a national bank to organize as a limited liability national association, this may be a particularly attractive option for community banks. The bank may then be able to take advantage of the pass-through tax treatment for comparable limited liability entities under certain tax laws and eliminate double taxation under which the same earnings are taxed both at the corporate level as corporate income and at the shareholder level as dividends. Some states currently permit state banks to be organized as unincorporated limited liability companies (LLCs) and the FDIC recently adopted a rule that allows certain state bank LLCs to qualify for Federal deposit insurance. This amendment would clarify that the OCC can permit national banks to organize in an alternative business form, such as an LLC.

Section 401 of the Act also simplifies the requirements that apply to a national bank that wishes to expand interstate by establishing branches *de novo*. Under the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994, interstate expansion through bank mergers generally is subject to a state "opt-out" that had to be in place by June 1, 1997. Under the time frames set by the statute, interstate bank mergers were permissible in all 50 states as of September 2001. By contrast, *de novo* branching still requires states to pass legislation to affirmatively "opt-in" to permit out-of-state banks to establish new branches in the state. Some states have done so, generally conditioning such *de novo* branching on reciprocal *de novo* branching being allowed by the home state of the bank proposing to branch in such a state.

The effect of current law is to require that, in many cases, banks must structure artificial and unnecessarily expensive transactions in order to establish a new branch across a state border -- which in some cases, is simply across town in a multi-state metropolitan area. Section 401 repeals the requirement that a state must adopt an express "opt-in" statute to permit the *de novo* branching form of interstate expansion for national banks and contains

parallel provisions for state member and non-member banks. Both state and national banks and their customers would benefit significantly by this change, which would permit a bank to freely choose which form of interstate expansion is most efficient for its needs and customer demands. In today's internet age, when customers can communicate remotely with banks located in any state, restrictions on where a bank may establish "branch" facilities to directly serve customers are an unnecessary legacy from a protectionist era that detract from healthy competition and customer service.

Federal Branches and Agencies of Foreign Banks

The OCC also licenses and supervises Federal branches and agencies of foreign banks. Federal branches and agencies generally are subject to the same rights and privileges, as well as the same duties, restrictions, penalties, liabilities, conditions and limitations and laws that apply to national banks. Thus, Federal branches and agencies will benefit equally from the provisions in the FSRR Act that reduce burden on national banks. Branches and agencies of foreign banks, however, also are subject to other requirements under the International Banking Act of 1978 (IBA) that are unique to their organizational structure and operations in the U.S. as an office of a foreign bank. The FSRR Act also includes provisions amending the IBA that are intended to reduce certain unnecessary burdens on Federal branches and agencies. We are supportive of these efforts. However, we believe that one of the provisions can be improved to achieve the full benefits of burden reduction and to preserve national treatment with national banks.

Section 107 provides that the OCC can set the capital equivalency deposit (CED) requirements for a Federal branch or agency as necessary to protect depositors and other investors and to be consistent with safety and soundness. However, that amount cannot be less than the amount required by a state for a state-licensed branch or agency in which the Federal branch or agency is located. This approach is a substantial improvement over the inflexibility of the current law. However, the CED requirements could be made even more risk-focused. The OCC has provided the Committee with an alternate that allows the OCC, after consultation with the Federal Financial Institutions Examination Council, to adopt regulations allowing the CED to be set on a risk-based institution-by-institution basis. Such an approach would more closely resemble the risk-based capital framework that applies to both national and state banks.

Information Sharing With Foreign Supervisors

A new provision added to the bill will be particularly helpful to the OCC and the other banking agencies in negotiating information sharing agreements with foreign supervisors. Section 610 clarifies that the OCC, Federal Reserve Board, FDIC, and OTS cannot be compelled to disclose information obtained from a foreign regulator under an information sharing agreement, or pursuant to other lawful procedures, if public disclosure of the information would cause the foreign authority to violate foreign law. However, nothing in this provision would allow the agency to withhold information from Congress or prevent the agency from complying with a court order in an action commenced by the United States or the agency. This clear statement in the law will facilitate information sharing and will provide foreign supervisors with assurances that public disclosure of confidential

supervisory information will be limited in cases in which such disclosures will violate foreign laws.

Safety and Soundness Provisions

The FSRR Act also contains a number of provisions that further the objective of promoting and maintaining the safety and soundness of the banking system. One of the most important of these provisions is section 405, which expressly authorizes the Federal banking agencies to enforce written agreements and conditions imposed in writing in connection with an application or when the agency imposes conditions as part of its decision not to disapprove a notice, *e.g.*, a Change in Bank Control Act (CBCA) notice.

This provision also would supersede recent Federal court decisions that conditioned the agencies' authority to enforce such conditions or agreements on a showing that the non-bank party to the agreement was "unjustly enriched." Section 405 also contains a valuable measure that clarifies that controlling parties and affiliates of banks many not evade their capital commitments to the bank through bankruptcy. These changes will enhance the safety and soundness of depository institutions and protect the deposit insurance funds from unnecessary losses. Finally, as stated earlier, this section also clarifies the banking agencies' authority to impose and enforce conditions in connection with the agency's decision not to object to a CBCA or other notice.

The Act also contains another provision that promotes safety and soundness by providing the Federal banking agencies with greater flexibility to manage resources more efficiently and deal more effectively with problem situations. Current law mandates that most banks be examined on-site on prescribed schedules. This can, in certain circumstances, interfere with the ability of the banking agencies to concentrate their supervisory oversight on the most problematic institutions. Section 601 of the bill would permit the agencies, when necessary for safety and soundness purposes, to adjust their mandatory examination schedules to concentrate resources on particularly troubled or risky institutions.

We also recommend that we and the other banking agencies have more flexibility in assigning our examiners to particular institutions. To further that goal, the banking agencies worked together to develop an amendment that broadly addresses particular ethical issues facing our examiners and we thank the Committee for including this provision in section 613 of the bill. Current law provides that criminal penalties may be imposed on a Federal bank examiner who examines a bank from which the examiner receives an extension of credit, including a credit card issued by that institution. The financial institution that extends such credit to the examiner also is subject to criminal penalties. This limits the flexibility of the OCC and the other banking agencies to assign examiners to particular institutions or examination teams, even if the extension of credit is on the bank's customary terms and the examiner's skills or expertise would contribute materially to the examination.

Section 613 provides that the Federal financial institutions regulatory agencies, including the Federal banking agencies, may grant exemptions from the prohibition to their

examiners by regulation or on a case-by-case basis if an extension of credit would not affect the integrity of the examination. The agencies must consult with each other in developing regulations providing for the exemptions and case-by-case exemptions only may be granted after applying certain specific factors. In addition, the amendment expressly provides that examiners may have credit cards without disqualification or recusal, but subject to the safeguard that the cards must be issued under the same terms and conditions as cards issued to the general public.

Section 603 of the FSRR Act also improves the Federal banking agencies' ability to keep bad actors out of our nation's depository institutions. This provision gives the Federal banking agencies the authority to prohibit a person convicted of a crime involving dishonesty, breach of trust, or money laundering from participating in the affairs of an uninsured national or state bank or uninsured branch or agency of a foreign bank without the consent of the agency. Under current law, the ability to keep these bad actors out of depository institutions applies only to *insured* depository institutions. Sec. 611 further would amend the law to provide the Federal Reserve Board with the authority to keep persons convicted of these offenses from participating in the affairs of a bank holding company or its nonbank subsidiaries, or an Edge or Agreement corporation. To further strengthen this authority, we recommend that this provision be expanded to clarify that the Federal banking agencies also can prohibit these persons from participating in the affairs of nonbank subsidiaries of the banks that we supervise.

Two other important new provisions have been added to the FSRR Act to promote safety and soundness. These provisions were developed on an interagency basis by the Federal banking agencies and, in my testimony last year, I recommended that these provisions be included in the bill.

First, under current law, independent contractors for insured depository institutions are treated more leniently under the enforcement provisions in the banking laws than are directors, officers, employees, controlling shareholders, or even agents for the institution or shareholders, consultants, and joint venture partners who participate in the affairs of the institution (institution-affiliated parties). To establish that an independent contractor, such as an accountant, has the type of relationship with the insured depository institution that would allow a Federal banking agency to take action against the accountant for a violation of law, breach of fiduciary duty, or an unsafe or unsound banking practice, the banking agency must show that the accountant "knowingly and recklessly" participated in such a violation. This standard is so high that it is extremely difficult for the banking agencies to take enforcement actions against accountants and other contractors who engage in wrongful conduct. Section 614 of the FSRR Act removes the "knowing and reckless" requirement to hold independent contractors to a standard that is more like the standard that applies to other institution-affiliated parties.

Second, section 409 amends the CBCA to address issues that have arisen for the banking regulators when a stripped-charter institution (*i.e.*, an insured bank that has no ongoing business operations because, for example, all of the business operations have been transferred to another institution) is the subject of a change-in-control notice. The

agencies' primary concern with such CBCA notices is that the CBCA is sometimes used as a way to acquire a bank with deposit insurance without submitting an application for a *de novo* charter and an application for deposit insurance. In general, the scope of review of a *de novo* charter application or deposit insurance application is more comprehensive than the statutory grounds for denial of a notice under the CBCA. There also are significant differences between the application and notice procedures. In the case of an application, the banking agency must affirmatively approve the request before a transaction can be consummated. Under the CBCA, if the Federal banking agency does not act to disapprove a notice within certain time frames, the acquiring person may consummate the transaction. In the case of a CBCA notice to acquire a stripped-charter institution, acquirers are effectively buying a bank charter without the scope of review that the law imposes when applicants seek a new charter, even though the risks presented by the two sets of circumstances may be substantively identical. To address these concerns, section 409 of the FSRR Act expands the criteria in the CBCA that allow a Federal banking agency to extend the time period to consider a CBCA notice so that the agency may consider business plan information and would allow the agency to use that information in determining whether to disapprove the notice.

Additional Suggestion To Improve Information Sharing

Another item that we recommend be included in the bill is an amendment that would permit all of the Federal banking agencies -- the OCC, FDIC, OTS, and the Federal Reserve Board -- to establish and use advisory committees in the same manner. Under current law, only the Board is exempt from the public disclosure requirements of the Federal Advisory Committee Act (FACA). The OCC, FDIC, and OTS, however, also supervise insured depository institutions and these institutions and their regulators have the same need to share information and to be able to conduct open and frank discussions about important supervisory and policy issues. Because of the potentially sensitive nature of this type of information, the public meeting and disclosure requirements under FACA could inhibit the supervised institutions from providing the OCC, FDIC, or OTS with their candid views. Our amendment would enhance the free exchange of information between all depository institutions and their Federal bank regulators with resulting safety and soundness benefits.

Bank Parity with Special Provisions for Thrifts

Finally, I note that the bill contains provisions providing beneficial treatment to Federal thrifts in areas where there is no reason to particularly distinguish Federal thrifts from national banks or State banks. These provisions include section 213 (Federal court diversity jurisdiction determined only on the basis of where an institution has its main office, eliminating consideration of where it has its principal place of business) and section 503 (eliminating geographic restrictions on thrift service companies). Similar issues may exist with respect to some of the other sections. The nature of these provisions is such that, if they are considered appropriate by the Subcommittee, there is no basis not to make them applicable to banks as well as thrifts.

Conclusion

Once again, Mr. Chairman, on behalf of the OCC, I thank you for your leadership in pursuing this legislation. As I have indicated, the OCC supports the Act and believes that many of its provisions will go far to promote the objectives I have described today. In the areas in which we have recommended that you consider additional improvements, we would be pleased to work with your staff to develop appropriate legislative language for the Subcommittee's consideration.

I am pleased to have had this opportunity to provide our views on this important initiative, and I would be happy to answer any questions you may have.

APPENDIX

H.R. 1375
"THE FINANCIAL SERVICES REGULATORY RELIEF ACT OF 2003"

SUMMARY AND COMMENTS OF THE OFFICE OF THE COMPTROLLER OF THE CURRENCY ON TITLES I, IV, AND VI

TITLE I -- NATIONAL BANK PROVISIONS

Sec. 101. National Bank Directors.

<u>SUMMARY:</u> This section would amend section 5146 of the Revised Statutes of the United States (12 U.S.C. § 72) to provide more flexible requirements regarding director qualifying shares for national banks operating, or seeking to operate, as Subchapter S corporations. The National Banking Act currently requires all directors of a national bank to own "shares of the capital stock" of the bank having an aggregate par value of at least $1,000, or an equivalent interest, as determined by the Comptroller, in a bank holding company that controls the bank. The amendment would permit the Comptroller to allow the use of a debt instrument that is subordinated to the interests of depositors, the Federal Deposit Insurance Corporation (FDIC), and other general creditors to satisfy the qualifying shares requirement for directors of national banks seeking to operate in Subchapter S status.

<u>OCC COMMENTS:</u> The OCC supports this change to the law. The requirement in current law creates difficulties for some national banks that operate in Subchapter S form. It effectively requires that all directors be shareholders, thus making it difficult or impossible for some banks to comply with the 75-shareholder limit that defines eligibility for the benefit of Subchapter S tax treatment, which avoids double tax on the bank's earnings. Such a subordinated debt instrument would have features resembling an equity interest, since the directors could only be repaid if all other claims of depositors and nondeposit creditors of the bank were first paid in full, including the FDIC's claims, if any. It would thus ensure that directors retain their personal stake in the financial soundness of the bank. However, the holding of such an instrument would not cause a director to be counted as a shareholder for purposes of Subchapter S.

Sec. 102. Voting in Shareholder Elections.

<u>SUMMARY:</u> This section would amend section 5144 of the Revised Statutes of the United States (12 U.S.C. § 61). Section 5144 imposes mandatory cumulative voting requirements on all national banks. This law currently requires that, in all elections of national bank directors,

each shareholder has the right to (1) vote for as many candidates as there are directors to be elected and to cast the number of votes for each candidate that is equal to the number of shares owned, or (2) cumulate his or her votes by multiplying the number of shares owned by the number of directors to be elected and casting the total number of these votes for only one candidate or allocating them in any manner among a number of candidates. This amendment would permit a national bank to provide in its articles of association which method of electing its directors best suits its business goals and needs and would provide the OCC with authority to issue regulations to carry out the purposes of this section.

OCC COMMENTS: The OCC supports this change to national banking law. The Model Business Corporation Act and most states' corporate codes provide that cumulative voting is optional. This amendment would conform this provision of the National Bank Act to modern corporate codes and would provide national banks with the same corporate flexibility available to most state corporations and state banks.

Sec. 103. Simplifying Dividend Calculations for National Banks.

SUMMARY: This section would amend section 5199 of the Revised Statutes of the United States (12 U.S.C. § 60) to simplify the formula for calculating the amount that a national bank may pay in dividends. The current law requires banks to follow a complex formula that is unduly burdensome and unnecessary for safety and soundness. The proposed amendment would retain certain safeguards in the current law that provide that national banks (and state member banks)[1] need the approval of the Comptroller (or the Federal Reserve Board (FRB) in the case of state member banks) to pay a dividend that exceeds the current year's net income combined with any retained net income for the preceding two years. For purposes of the approval requirement, these Federal regulators would retain the authority to reduce the amount of a bank's "net income" by any required transfers to funds, such as a sinking fund for retirement of preferred stock.

OCC COMMENTS: The OCC supports this amendment. The amendment would reduce burden on banks in a manner that is consistent with safety and soundness. Among other things, the amendment would ensure that the OCC (and the FRB for state member banks) will continue to have the opportunity to deny any dividend request that may deplete the net income of a bank that may be moving towards troubled condition. Importantly, the amendment would not affect other safeguards in the National Bank Act (12 U.S.C. 56). These provisions generally prohibit national banks from withdrawing any part of their permanent capital or paying dividends in excess of undivided profits except in certain circumstances.

Moreover, other safeguards, such as Prompt Corrective Action, have been enacted in the last ten years that provide additional safety and soundness protections for all insured depository institutions. The proposed amendment would not affect the applicability of these safeguards. These additional safeguards prohibit any insured depository institution from paying any dividend if, after that payment, the institution would be undercapitalized (see 12 U.S.C. § 1831o(d)(1)).

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[1] See 12 U.S.C. 324 and 12 C.F.R. 208.5 generally applying the national bank dividend approval requirements to state member banks.

Sec. 104. Repeal of Obsolete Limitation on Removal Authority of the Comptroller of the Currency.

SUMMARY: This provision amends section 8(e)(4) of the Federal Deposit Insurance Act (FDIA) (12 U.S.C. § 1818(e)(4)) relating to the procedures for the removal of an institution-affiliated party (IAP) from office or participation in the affairs of an insured depository institution. With respect to national banks, current law requires the OCC to certify the findings and conclusions of an Administrative Law Judge to the FRB for the FRB's determination as to whether any removal order will be issued. This amendment would remove this certification and FRB approval process and allow the OCC directly to issue the removal order with respect to national banks.

OCC COMMENTS: The OCC supports this amendment. This present system stems from historical decisions made by Congress on circumstances that are no longer applicable. Originally, the role of the OCC in removal cases was to certify the facts of the case to the FRB. The FRB then made the decision to pursue the case and made the final agency decision. At that time, the Comptroller was a member of the FRB and therefore participated in the FRB's final removal decision. However, Congress later removed the Comptroller from the FRB and gave the OCC the authority to issue suspensions and notices of intention to remove.

All of the Federal banking agencies, except the OCC, may remove a person who engages in certain improper conduct from the banking business. In the case of the OCC, the determination of whether to remove an individual from a national bank (and thus from the banking business) is made by the FRB. This amendment would give the Comptroller the same removal authority as the other banking agencies to issue orders to remove persons who have been determined under the statute to have, for example, violated the law or engaged in unsafe or unsound practices in connection with an insured depository institution. Like the other banking agencies, the Comptroller should make these decisions about persons who engage in improper conduct in connection with the institutions for which the Comptroller is the primary supervisor. This is a technical change to streamline and expedite these actions and has no effect on a person's right to seek judicial review of any removal order. The FRB also supports this amendment.

Sec. 105. Repeal of Intrastate Branch Capital Requirements.

SUMMARY: This provision would amend section 5155(c) of the Revised Statutes of the United States (12 U.S.C. § 36(c)) to repeal the requirement that a national bank, in order to establish an intrastate branch in a state, must meet the capital requirements imposed by the state on state banks seeking to establish intrastate branches.

OCC COMMENTS: The OCC supports this technical amendment to repeal the obsolete capital requirement for the establishment of intrastate branches by national banks. This amendment passed the House on October 9, 1998 in Sec. 306 of H.R. 4364, the Depository Institution Regulatory Streamlining Act of 1998, and was also included in later legislation introduced in the House. This requirement is not necessary for safety and soundness. Branching restrictions are

already imposed under other provisions of law to limit the operations of a bank if it is in troubled condition. See 12 U.S.C. § 1831o(e) (prompt corrective action).

Sec. 106. Clarification of Waiver of Publication Requirements for Bank Merger Notices.

SUMMARY: This section would amend sections 2(a) and 3(a)(2) of the National Bank Consolidation and Merger Act (12 U.S.C. § 215(a) and 215a(a)(2), respectively) concerning the newspaper publication requirement of a shareholder meeting to vote on a consolidation or merger of a national bank with another bank located within the same state. This change would clarify that the publication requirement may be waived by the Comptroller in the case of an emergency situation or by unanimous vote of the shareholders of the national or state banks involved in the transaction.

This amendment does not affect other requirements in the law. The current law also requires that the consolidation or merger must be approved by at least a 2/3 vote of the shareholders of each bank involved in the transaction. In addition, the shareholders of the banks generally must receive notice of the meeting by certified or registered mail at least ten days prior to the meeting. These provisions are not changed.

OCC COMMENTS: The OCC supports this amendment. The amendment would clarify the intent of the statute and remove any ambiguity as to its meaning.

Sec. 107. Capital Equivalency Deposits for Federal Branches and Agencies of Foreign Banks.

SUMMARY: This section would amend section 4(g) of the International Banking Act of 1978 (IBA) (12 U.S.C. § 3102(g)) with respect to the Comptroller's authority to set the amount of the capital equivalency deposit (CED) for a Federal branch or agency. The CED is intended to ensure that assets will be available in the U.S. for creditors in the event of liquidation of a U.S. branch or agency. The current CED statute that applies to foreign banks operating in the U.S. through a Federal license may impose undue regulatory burdens without commensurate safety and soundness benefits. These burdens include obsolete requirements about where the deposit must be held and the amount of assets that must be held on deposit. As a practical matter, the IBA sets the CED at 5% of total liabilities of the Federal branch or agency and provides that the CED must be maintained in such amount as determined by the Comptroller. As a result, Federal branches and agencies often must establish a CED that is larger than the capital that would be required for a bank of corresponding size or for a similar size State-chartered foreign branch or agency in major key States.

Section 107 provides that the OCC can set the CED requirements for a Federal branch or agency as necessary to protect depositors and other investors and to be consistent with safety and soundness. However, that amount cannot be less than the amount required by a state for a state-licensed branch or agency in the state in which the Federal branch or agency is located.

OCC COMMENTS: Section 107 represents a substantial improvement over the inflexibility of current law; however, the CED standards could be made even more risk-focused. Last year and again this year the OCC provided the Committee with an amendment that allows the OCC, after consultation with the Federal Financial Institutions Examination Council (FFIEC), to adopt regulations allowing the CED to be set on a risk-based institution-by-institution basis. Such an approach would more closely resemble the risk-based capital framework that applies to national and state banks. The FRB has no objections to the OCC's amendment.

Sec. 108. Equal Treatment for Federal Agencies of Foreign Banks.

SUMMARY: This section would amend section 4(d) of the IBA (12 U.S.C. § 3102(d)) to provide that the prohibition on uninsured deposit-taking by Federal agencies of foreign banks applies only to deposits from U.S. citizens or residents. As a result, a Federal agency would be able to accept uninsured foreign source deposits from non-U.S. citizens. State agencies of foreign banks may accept uninsured deposits from parties who are neither residents nor citizens of the United States, if so authorized under state law. However, due to slight language differences in the IBA, the D.C. Circuit Court of Appeals has held that Federal agencies cannot accept any deposits, including those from noncitizens who reside outside of the United States. Conference of State Bank Supervisors v. Conover, 715 F.2d 604, 623 (D.C. Cir. 1983).

OCC COMMENTS: The OCC supports this amendment. This amendment would allow Federal agencies to accept the limited *uninsured* foreign source deposits that state agencies may accept under the IBA. As a result, the amendment would repeal an unnecessary regulatory burden that has competitively disadvantaged Federal agencies and prevented them from offering the same services to foreign customers that may be offered by state agencies. Because these deposits are not insured, this amendment does not pose any risks to the deposit insurance fund.

Sec. 109. Maintenance of a Federal Branch and a Federal Agency in the Same State.

SUMMARY: This section would amend section 4(e) of the IBA (12 U.S.C. § 3102(e)) to provide that a foreign bank is prohibited from maintaining both a Federal agency and a Federal branch in the same state only *if* state law prohibits maintaining both an agency and a branch in the state. Current law prohibits a foreign bank from operating both a Federal branch and a Federal agency in the same state notwithstanding that state law may allow a foreign bank to operate both types of offices.

OCC COMMENTS: The OCC supports this change. According to the legislative history of the current provision, this prohibition was included in the IBA to maintain parity with state operations. However, today some states permit foreign banks to maintain both a branch and agency in the same state. Florida law permits a foreign bank to operate more than one agency, branch, or representative office in Florida (*see* Fla. Stat. Ann. § 663.06). Other states, such as Connecticut, also may permit a foreign bank to have both a state branch and a state agency (*see* Conn. Gen. Stat. Ann. § 36a-428). This amendment would repeal an outdated regulatory burden

in current law and permit a foreign bank to maintain both a Federal branch and a Federal agency in those states that do not prohibit a foreign bank from maintaining both of these offices. This change would enhance national treatment and give foreign banks more flexibility in structuring their U.S. operations.

Sec. 110. Business Organization Flexibility for National Banks.

SUMMARY: This section would amend the Revised Statutes of the United States (12 U.S.C. § 21 *et seq.*) to clarify the Comptroller's authority to adopt regulations allowing national banks to be organized in different business forms. Notwithstanding the form of organization, however, all national banks would continue to have the same rights and be subject to the same restrictions and requirements except to the extent that differences are appropriate based on the different forms of organization.

OCC COMMENTS: The OCC strongly supports this amendment. This amendment would reduce burden on national banks and allow them to choose among different business organizational forms, as permitted by the Comptroller, and to select the form that is most consistent with the their business plans and operations so that it may operate in the most efficient manner. Certain alternative business structures may be particularly attractive for community banks. For example, if the Comptroller should permit a national bank to be organized as a limited liability national association and establish the characteristics of such a national bank, the bank then may be able to take advantage of the pass-through tax treatment for comparable limited liability entities under certain tax laws and eliminate double taxation under which the same earnings are taxed both at the corporate level as corporate income and at the shareholder level as dividends.

Some states currently permit state banks to be organized as unincorporated limited liability companies (LLCs) and the FDIC recently adopted a rule that will result in certain state bank LLCs being eligible for Federal deposit insurance. Clarifying that national banks also may be organized in alternative business forms will provide a level playing field.

Sec. 111. Clarification of the Main Place of Business of a National Bank.

SUMMARY: This section would amend two sections in the Revised Statutes of the United States (12 U.S.C. §§ 22 and 81). The amendment would replace obsolete language that is used in these two sections with the modern term "main office."

OCC COMMENTS: The OCC supports these technical amendments. The change to 12 U.S.C. § 22 would clarify that the information required to be included in a national bank's organization certificate is the location of its *main office*. The change of 12 U.S.C. § 81 would clarify that the general business of a national bank shall be transacted in its *main office* and in its branch or branches. Both statutes currently use obsolete terms to describe a main office of a national bank.

TITLE IV -- DEPOSITORY INSTITUTION PROVISIONS

Sec. 401. Easing Restrictions on Interstate Branching and Mergers.

SUMMARY: This section would amend section 5155(g) of the Revised Statutes of the United States (12 U.S.C. § 36(g)), section 18(d)(4) of the FDIA (12 U.S.C. § 1828(d)(4)), section 9 of the Federal Reserve Act (12 U.S.C. § 321), and section 3(d)(1) of the Bank Holding Company Act (BHCA) (12 U.S.C. § 1842(d)(1)) to ease certain restrictions on interstate banking and branching. Under the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 (Riegle-Neal Act), an out-of-state national or state bank may establish a de novo branch in a state only if that state has adopted legislation affirmatively "opting in" to de novo branching. This amendment would repeal the requirement that a state expressly must adopt an "opt-in" statute to permit the de novo branching form of interstate expansion.

In addition, the Riegle-Neal Act permits a state to prohibit an out-of-state bank or bank holding company from acquiring an in-state bank that has not been in existence for up to five years. This amendment also would repeal the state age requirement.

Also, the amendment would amend the FDIA to authorize consolidations or mergers between an insured bank and a noninsured bank with different home states and amend national banking law relating to consolidations or mergers between noninsured national banks and other noninsured banks with different home states.

OCC COMMENTS: The OCC supports the changes to the law to remove the restrictions on interstate de novo branching. Enactment of this amendment should enhance competition in banking services with resulting benefits for bank customers. Moreover, it will ease burdens on banks that are planning interstate expansion through branches and would give banks greater flexibility in formulating their business plans and in making choices about the form of their interstate operations.

Under the Riegle-Neal Act, interstate expansion through bank mergers generally is subject to a state "opt-out" that had to be in place by June 1, 1997. While two states "opted out" at the time, interstate bank mergers are now permissible in all 50 states. By contrast, de novo branching by banks requires states to pass legislation to affirmatively "opt-in" to permit out-of-state banks to establish new branches in the state. This requires banks in many cases to structure artificial and unnecessarily expensive transactions in order for a bank to simply establish a new branch across a state border. However, Federal thrifts are not similarly restricted and generally may branch interstate without the state law "opt-in" requirements that are imposed on banks.

In addition, the OCC supports the amendments that would repeal the state age requirement. This additional limitation on bank acquisitions by out-of-state banking organizations is no longer necessary if interstate de novo branching is permitted.

Sec. 402. Statute of Limitations for Judicial Review of Appointment of a Receiver for Depository Institutions.

SUMMARY: This provision would amend section 2 of the National Bank Receivership Act (12 U.S.C. § 191) and section 11(c)(7) of the FDIA (12 U.S.C. § 1821(c)(7)) to provide for a 30-day period to judicially challenge a determination by the OCC to appoint a receiver for a national bank under the National Bank Receivership Act or by the FDIC to appoint itself as receiver under the FDIA under certain conditions. Current law generally provides that challenges to a decision by the OTS to appoint a receiver or conservator for an insured savings association or the FDIC to appoint itself as receiver or conservator for an insured state depository institution must be raised within 30 days of the appointment. 12 U.S.C. §§ 1464(d)(2)(B), 1821(c)(7). There is, however, no statutory limit on a national bank's ability to challenge a decision by the OCC to appoint a receiver of an insured or uninsured national bank.[2] As a result, the general six-year statute of limitations for actions against the U.S. applies to the OCC's receiver appointments. See James Madison, Ltd. v. Ludwig, 82 F.3d 1085 (D.C. Cir. 1996).

Moreover, under the FDIA, there are some circumstances under which FDIC may be appointed or appoint itself as receiver or conservator for an insured depository institution that are not specifically subject to the general 30-day judicial review period. As a technical matter, the amendment also would harmonize these provisions in the FDIA with the general 30-day rule.

Finally, the amendment would provide that the changes made in the statute of limitations under these provisions applies with respect to conservators, receivers, or liquidating agents appointed on or after the date of enactment of the new law.

OCC COMMENTS: The OCC supports this amendment to national banking law. This amendment passed the House on October 9, 1998 in Sec. 304 of H.R. 4364, the Depository Institution Regulatory Streamlining Act of 1998, and was also included in later legislation introduced in the House. The six-year protracted time period under current law severely limits the OCC's authority to manage insolvent national banks that are placed in receivership by the agency and the ability of the FDIC to wind up the affairs of an insured national bank in a timely manner with legal certainty. (In the case of an insured national bank that is placed in receivership by the OCC, the FDIC must be appointed the receiver.) This amendment would make the statute of limitations governing the appointment of receivers of national banks consistent with the time period that generally applies to other depository institutions. The amendment would not affect a national bank's ability to challenge a decision by the OCC to appointment a receiver, but simply require that these challenges must be brought in a timely manner and during the same time frame that generally applies to other depository institutions.

Sec. 403. Reporting Requirements Relating to Insider Lending.

SUMMARY: This provision would amend section 22(g) of the Federal Reserve Act (12 U.S.C. § 375a) and section 106(b)(2) of the Bank Holding Company Act Amendments of 1970 (12

[2] Under current law, there is a 20-day statute of limitations for challenges to the OCC's decision to appoint a conservator of a national bank. 12 U.S.C. § 203(b)(1).

U.S.C. § 1972(2)) to eliminate certain reporting requirements concerning loans made to insiders. Specifically, the reports that would be eliminated are (1) the report that must be filed with a bank's board of directors when an executive officer of the bank obtains certain types of loans from another bank that exceeds the amount the officer could have obtained from his or her own bank, (2) the supplemental report a bank must file with its quarterly call report identifying any loans made to executive officers during the previous quarter, and (3) an annual report filed with a bank's board of directors by its executive officers and principal shareholders regarding outstanding loans from correspondent banks.

OCC COMMENTS: The OCC supports these amendments. Nothing in these amendments affects the insider lending restrictions that apply to national banks or the OCC's enforcement of those restrictions. Moreover, the OCC believes that it will continue to have access to sufficient information during the examination process to review a national bank's compliance with the insider lending laws. Under the OCC's regulations, national banks are required to follow the FRB's regulations regarding insider lending restrictions and reporting requirements (see 12 C.F.R. § 31.2). The FRB's regulations require member banks to maintain detailed records of all insider lending. In addition, the OCC has the authority under 12 U.S.C. § 1817(k) to require any reports that it deems necessary regarding extensions of credit by a national bank to any of its executive officers or principal shareholders, or the related interests of such persons.

Sec. 404. Amendment to Provide an Inflation Adjustment for the Small Depository Institution Exception under the Depository Institution Management Interlocks Act.

SUMMARY: This provision would amend section 203(1) of the Depository Institutions Management Interlock Act (DIMIA) (12 U.S.C. § 3202(1)). Under current law, generally a management official may not serve as a management official of any other nonaffiliated depository institution or depository institution holding company if (1) their offices are located or they have an affiliate located in the same MSA, or (2) the institutions are located in the same city, town, or village, or a city, town, or village that is contiguous or adjacent thereto. For institutions of less than $20 million in assets, the SMSA restriction does not apply. The amendment would increase the current $20 million exemption to $100 million.

OCC COMMENTS: The OCC supports this amendment. This $20 million cap has not been amended since the current law was originally enacted in 1978. However, the asset size of FDIC-insured commercial banks between 1976 and 2000 has increased over five fold. Depository institutions of all sizes will continue to be subject to the city, town, or village test.

Sec. 405. Enhancing the Safety and Soundness of Insured Depository Institutions.

SUMMARY: This provision would add a new section to the FDIA (12 U.S.C. § 1811, et seq.) to provide that the Federal banking agencies may enforce the terms of (1) conditions imposed in writing in connection with an application, notice, or other request, and (2) written agreements. The amendment also would clarify the existing authority of the FDIC as receiver or conservator

to enforce written conditions or agreements entered into between insured depository institutions and IAPs.

Finally, the amendment would amend section 18(u) of the FDIA (12 U.S.C. § 1828(u)). This section of the law provides that certain transfers to depository institutions to bolster their capital cannot be reversed under the Bankruptcy Code or other law if the affiliate or controlling shareholder making the transfer later becomes bankrupt. The amendment would delete the requirement that the insured depository institution had to be undercapitalized at the time of the transfer for the transfer to be protected under this provision.

OCC COMMENTS: The OCC supports these changes to the law. This amendment enhances the safety and soundness of depository institutions and protects the deposit insurance funds from unnecessary losses. This amendment is intended to reverse some court decisions that question the authority of the agencies to enforce such conditions or agreements against institution-affiliated parties (IAP) without first establishing that the IAP was unjustly enriched. In addition, the amendment would clarify that a condition imposed by a banking agency in connection with the nondisapproval of a notice, *e.g.,* a notice under the Change in Bank Act, can be imposed and enforced under the FDIA. Finally, the OCC also supports the change to section 18(u) of the FDIA. The amendment enhances safety and soundness by protecting the capital of insured depository institutions.

Sec. 406. Investments by Insured Savings Associations in Bank Service Companies Authorized.

SUMMARY: This section would amend the Bank Service Company Act (12 U.S.C. § 1861, *et seq.*) to allow an insured savings association to be an investor in a bank service company. Under current law, a bank service company must be owned by one or more insured *banks* and, thus, a savings association cannot invest in these entities. In addition, this provision would amend section 5(c)(4)(B) of the Home Owners' Loan Act (HOLA) (12 U.S.C. § 1464(c)(4)(B)) to provide that a Federal savings association may invest in a service company under HOLA if the company is owned by state and Federal *depository institutions*. Under current law, a Federal savings association may invest in a service company under HOLA only if the corporation is organized under the laws of the state in which the association's home office is located and the corporation is owned only by state and Federal *savings associations* having their home offices in such state. Another provision in this bill, Sec. 503, would amend HOLA to eliminate the geographic limits on service companies authorized under that law and, thus, would no longer require that the company must be located in the investors' home state.

OCC COMMENTS: The OCC does not object to section 406, but suggests that if, under section 503, geographic limits on thrift service companies are eliminated, geographic restrictions on bank service companies should similarly be lifted.

Sec. 407. Cross Guarantee Authority.

SUMMARY: This section would amend section 5(e)(9)(A) of the FDIA (12 U.S.C. § 1815(e)(9)(A)) to provide that, for purposes of determining liability of commonly controlled depository institutions for FDIC losses, institutions are commonly controlled if they are controlled by the same company. Under current law, institutions are only commonly controlled if controlled by the same "depository institution holding company." Such a holding company includes only a bank holding company or savings and loan holding company. However, if the subsidiary institution is, for example a credit card bank or a trust company, it is not a "bank" for purposes of the BHCA. Because the holding company is not a bank holding company, there is no cross guarantee liability under current law.

OCC COMMENTS: The OCC supports this amendment, which would correct a gap in the current law to ensure that cross guarantee liability applies equally to any company that controls more than one insured depository institution.

Sec. 408. Golden Parachute Authority and Nonbank Holding Companies.

SUMMARY: This section would amend section 18(k) of the FDIA (12 U.S.C. § 1828(k)) to clarify the FDIC's authority to limit golden parachute payments or indemnification payments made by any company that controls an insured depository institution. Similar to the provision summarized in Sec. 407, current law only applies to "depository institution holding companies."

OCC COMMENTS: The OCC also supports this amendment to correct a gap in the law.

Sec. 409. Amendments Relating to Change in Bank Control.

SUMMARY: This section would amend the Change in Bank Control Act (CBCA) in section 7(j) of the FDIA (12 U.S.C. § 1817(j)) to expand the criteria that would allow a Federal banking agency to extend the time period to consider a CBCA notice. Under the CBCA, a Federal banking agency must disapprove a CBCA notice within certain time frames or the transaction may be consummated. Initially, the agency has up to 90 days to issue a notice of disapproval. The agency may extend that period for up to an additional 90 more days if certain criteria are satisfied and this amendment provides for new criteria that would allow an agency to extend the time period under this additional up to 90-day period. The new criteria that an agency could use to extend the time period can provide the agency more time to analyze the future prospects of the institution or the safety and soundness of the acquiring party's plans to sell the institution or make changes in its business operations, corporate structure, or management. Moreover, the amendment would permit the agencies to use that information as a basis to issue a notice of disapproval.

OCC COMMENTS: The OCC supports this amendment, which is jointly recommended by the Federal banking agencies. This amendment will address issues that have arisen for the banking regulators when a stripped-charter institution (*i.e.,* an insured bank that has no ongoing business operations because, for example, all of the business operations have been merged into another institution) is the subject of a CBCA notice. The agencies' primary concern with such CBCA

notices is that the CBCA is sometimes used as a way to acquire a bank with deposit insurance without submitting an application for a *de novo* charter and an application for deposit insurance. In general, the scope of review of a *de novo* charter application or deposit insurance application is more comprehensive than the statutory grounds for the denial of a notice under the CBCA. There are also significant differences between the application and notice procedures. In the case of an application, the banking agency must affirmatively approve the request before a transaction can be consummated. Under the CBCA, if the Federal banking agency does not act to disapprove a notice within certain time frames, the acquiring person may consummate the transaction. In the case of a CBCA notice to acquire a stripped-charter institution, acquirers are effectively buying a bank charter without the requirement for prior approval and without the scope of review that the law imposes when applicants seek a new charter, even though the risks presented by the two sets of circumstances may be substantively identical. Section 409 expands the criteria in the CBCA that allows a Federal banking agency to extend the time period to consider a CBCA notice so that the agency may consider the acquiring party's business plans and the future prospects of the institution and use that information in determining whether to disapprove the notice.

TITLE VI -- BANKING AGENCY PROVISIONS

Sec. 601. Waiver of Examination Schedule in Order to Allocate Examiner Resources.

SUMMARY: This section would amend section 10(d) of the FDIA (12 U.S.C. § 1820(d)) to provide that an appropriate Federal banking agency may make adjustments in the examination cycle for an insured depository institution if necessary for safety and soundness and the effective examination and supervision of insured depository institutions. Under current law, insured depository institutions must be examined by their appropriate Federal banking agencies at least once during a 12-month period in a full-scope, on-site examination unless an institution qualifies for the 18-month rule. Small insured depository institutions with total assets of less than $250 million and that satisfy certain other requirements may be examined on an 18-month basis rather than a 12-month cycle. The amendment would permit the banking agencies to make adjustments in the scheduled examination cycle as necessary for safety and soundness.

OCC COMMENTS: The OCC supports this amendment. It would give the appropriate Federal banking agencies the discretion to adjust the examination cycle of insured depository institutions to ensure that examiner resources are allocated in a manner that provides for the safety and soundness of insured depository institutions. For example, as deemed appropriate by a Federal banking agency, a well-capitalized and well-managed bank's examination requirement for an annual or 18-month examination could be extended if the agency's examiners were needed to immediately examine troubled or higher risk institutions. This amendment would permit the agencies to use their resources in the more efficient manner.

Sec. 602. Interagency Data Sharing.

<u>SUMMARY:</u> This section would amend the FDIA (12 U.S.C. § 1811, *et seq.*). The amendment would provide that a Federal banking agency has the discretion to furnish any confidential supervisory information, including a report of examination, about a depository institution or other entity examined by the agency to another Federal or state supervisory agency and to any other person deemed appropriate. Similar changes are also made to the Federal Credit Union Act.

<u>OCC COMMENTS:</u> The OCC supports this provision. This provision will give the other Federal banking agencies parallel authority to share confidential information that was given to the FRB in Sec. 727 of the Gramm-Leach-Bliley Act (GLBA). We note, however, that this provision is discretionary and nothing in this provision would compel a banking agency to disclose confidential supervisory information that it has agreed to keep confidential pursuant to an information sharing or other agreement with another supervisor. *See also* Sec. 610.

Sec. 603. Penalty for Unauthorized Participation by Convicted Individual.

<u>SUMMARY:</u> This section would amend section 19 of the FDIA (12 U.S.C. § 1829) to give the Federal banking agencies the authority to prohibit a person convicted of a crime involving dishonesty, breach of trust, or money laundering from participating in the affairs of an uninsured national or state bank or uninsured branch or agency of a foreign bank without the consent of the agency. Under current law, the ability to keep these bad actors out of depository institutions applies only to *insured* depository institutions. Sec. 611 also would amend 12 U.S.C. § 1829 to give the FRB the authority to keep persons convicted of these offenses from participating in the affairs of a bank holding company or its nonbank subsidiaries, or an Edge or Agreement corporation.

<u>OCC COMMENTS:</u> The OCC supports these changes to the law. This amendment will help to provide for the safe and sound operations of uninsured, as well as insured, institutions. We recommend, however, that the provision be clarified so that the Federal banking agencies also may prevent a person convicted of such offenses from participating in the affairs of nonbank subsidiaries of depository institutions.

Sec. 604. Amendment Permitting the Destruction of Old Records of a Depository Institution by the FDIC After the Appointment of the FDIC as Receiver.

<u>SUMMARY:</u> This provision would amend section 11(d)(15)(D) of the FDIA (12 U.S.C. § 1821(d)(15)(D)) to modify the record retention requirement of old records that must be maintained by the FDIC after a receiver is appointed for a failed insured depository institution. Under current law, the FDIC must preserve all records of a failed institution for six years from the date a receiver is appointed. This requirement is not dependent on the actual age of the records at the time the receiver is appointed. After the six-year period, the FDIC may destroy any unnecessary records, unless directed to retain the records by a court or a government agency or otherwise prohibited from destroying the records by law. The amendment would permit the

FDIC to destroy unnecessary records that are 10 or more years old on the date the receiver is appointed unless prohibited from doing so by a court, a government agency, or law.

OCC COMMENTS: The OCC supports this change and recommends that a similar provision be included in national banking law. The OCC appoints receivers for all national banks, both insured and uninsured. The FDIC only is required to accept the appointment for insured national banks. Thus, a receiver for an uninsured national bank would not be the FDIC. Adding a similar provision to national banking law also would clarify for a receiver of a national bank, other than the FDIC, that these outdated records may be destroyed.

Sec. 605. Modernization of FDIC Recordkeeping Requirement.

SUMMARY: This section would amend section 10(f) of the FDIA (12 U.S.C. § 1820(f)) to provide that the FDIC may retain records in electronic or photographic form and that such documents shall be deemed to be an original record for all purposes, including as evidence in court and administrative proceedings.

OCC COMMENTS: The OCC supports this amendment and recommends that it be expanded to apply to all of the Federal banking agencies.

Sec. 606. Clarification of Extent of Suspension, Removal, and Prohibition Authority of Federal Banking Agencies in Cases of Certain Crimes by Institution-Affiliated Parties.

SUMMARY: This provision would amend section 8(g) of the FDIA (12 U.S.C. § 1818(g)) to clarify that the appropriate Federal banking agency may suspend or prohibit IAPs charged with or convicted of certain crimes (including those involving dishonesty, breach of trust, or money laundering) from participating in the affairs of any depository institution and not only the institution with which the party is or was last affiliated. The amendment would also clarify that the section 8(g) authority applies even if the IAP is no longer associated with any depository institution at the time the order is considered or issued or the depository institution with which the IAP was associated is no longer is existence.

Under current law, if an IAP is charged with such a crime, the suspension or prohibition will remain in effect until the charge is finally disposed of or until terminated by the agency. If the individual is convicted of such a crime, the party may be served with a notice removing the party from office and prohibiting the party for further participating in the affairs of a depository institution without the consent of the appropriate Federal banking agency. Before an appropriate Federal banking agency may take any of these actions under section 8(g), the agency must find that service by the party may pose a threat to interests of depositors or impair public confidence in a depository institution. The statute further provides that an IAP that is suspended or removed under section 8(g) may request a hearing before the agency to rebut the agency's findings. Unless otherwise terminated by the agency, the suspension or order of removal remains in effect until the hearing or appeal is completed. Current law, however, applies only to the depository

institution with which the IAP is associated. Similar amendments are made to the Federal Credit Union Act.

OCC COMMENTS: The OCC supports the amendment to the FDIA. This amendment will help to ensure that, if a Federal banking agency makes the required findings, the agency has adequate authority to suspend or prohibit an IAP charged with or convicted of such crimes from participating in the affairs of any depository institution.

Sec. 607. Streamlining Depository Institution Merger Application Requirements.

SUMMARY: This section would amend the Bank Merger Act (BMA) (12 U.S.C. § 1828(c)). The amendment would provide that the responsible agency in a merger transaction, which is generally the Federal banking agency that has the primary regulatory responsibility for the resulting bank, must request a competitive factors report only from the Attorney General, with a copy to the FDIC. Under current law, this report must be requested from all of the other Federal banking agencies but the other agencies are not required to file a report.

OCC COMMENTS: The OCC supports this amendment. It appropriately streamlines the agencies' procedures in processing BMA transactions.

Sec. 608. Inclusion of Director of the Office of Thrift Supervision in List of Banking Agencies Regarding Insurance Customer Protection Regulations.

SUMMARY: This provision would amend section 47(g)(2)(B)(i) of the FDIA (12 U.S.C. § 1831x(g)(2)(B)(i)) to add OTS to the list of the Federal banking agencies that must jointly make certain determinations before certain state customer protection laws may be preempted. Under current law, OTS is one of the Federal banking agencies that are required to adopt the Federal regulations that would provide the basis for the preemption determination but is not included in the list of agencies that must make the preemption determination.

OCC COMMENTS: The OCC does not object to this provision.

Sec. 609. Shortening of Post-Approval Antitrust Review Period with the Agreement of the Attorney General.

SUMMARY: This provision would amend section 11(b)(1) of the BHCA (12 U.S.C. § 1849(b)(1)) and section 18(c)(6) of the BMA (12 U.S.C. § 1828(c)(6)) to permit the shortening of the post-approval waiting period for certain bank acquisitions and mergers. Under current law, the post-approval waiting period generally is 30 days from the date of approval by the appropriate Federal banking agency. The waiting period gives the Attorney General time to take action if the Attorney General determines that the transaction will have a significant adverse effect on competition. The waiting period under both the BHCA and BMA, however, may be shortened to 15 days if the appropriate banking agency and the Attorney General agree that no

such effect on competition will occur. The proposed amendment would shorten the mandatory 15-day waiting period to 5 days.

OCC COMMENTS: The OCC supports this change. It will give the banking agency and the Attorney General more flexibility to shorten the post-approval waiting period as appropriate for those transactions that do not raise competitive concerns. If such concerns exist, the 30-day waiting period will continue to apply. This change will not affect the waiting periods for transactions that involve bank failures or emergencies. In those cases, the statute already provides for other time frames.

Sec. 610. Protection of Confidential Information Received By Federal Banking Regulators from Foreign Banking Supervisors.

SUMMARY: This section would amend section 15 of the IBA (12 U.S.C. § 3109) to add a provision that ensures that the FRB, OCC, and FDIC cannot be compelled to disclose information obtained from a foreign supervisor if public disclosure of this information would be a violation of foreign law and the U.S. banking agency obtained the information pursuant to an information sharing arrangement with the foreign supervisor or other procedure established to administer and enforce the banking laws. The banking agency, however, cannot use this provision as a basis to withhold information from Congress or to refuse to comply with a valid court order in an action brought by the U.S. or the agency.

OCC COMMENTS: The OCC supports this provision. This amendment would provide assurances to foreign supervisors that the banking agencies cannot be compelled to disclose publicly confidential supervisory information that the agency has committed to keep confidential, except under the limited circumstances described in the amendment. This authority is similar to the authority provided to the Securities and Exchange Commission under the securities laws (15 U.S.C. § 78q(h)(5)). Some foreign supervisors have been reluctant to enter into information sharing agreements with U.S. banking agencies because of concerns that the U.S. agency may not be able to keep the information confidential and public disclosure of the confidential information provided could subject the supervisor to a violation of its home country law. This amendment will be helpful to ease those concerns and will facilitate information sharing agreements that enable U.S. and foreign supervisors to obtain necessary information to supervise institutions operating internationally.

Sec. 611. Prohibition on the Participation in the Affairs of Bank Holding Company or Edge Act or Agreement Corporations by Convicted Individual.

SUMMARY: This section also would amend section 19 of the FDIA (*see also* Sec. 603). It will give the FRB the authority to prohibit a person convicted of an offense involving dishonesty, breach of trust, or money laundering from participating in the affairs of a bank holding company, its nonbank subsidiaries, or an Edge or Agreement Corporation without the consent of the FRB.

OCC COMMENTS: The OCC supports expanding the banking agencies' authority to keep bad actors out of our financial firms. We recommend, however, that the provision be clarified so that the Federal banking agencies may prevent persons convicted of such offenses from participating in the affairs of nonbank subsidiaries of depository institutions.

Sec. 612. Clarification that Notice After Separation from Service May be Made by an Order.

SUMMARY: This section would amend section 8(i)(3) of the FDIA (12 U.S.C. § 1818(i)(3)) to clarify that, when a Federal banking agency takes an enforcement action against an IAP who has resigned or is otherwise separated from an insured depository institution, the agency can take such action by notice or issuing an order.

OCC COMMENTS: The OCC supports this technical clarification to the law. Enforcement actions under 12 U.S.C. § 1818 generally provide that actions against IAPs can be taken in the form of a notice or an order and this amendment clarifies that the same is true for actions against IAPs under this provision of § 1818.

Sec. 613. Examiners of Financial Institutions.

SUMMARY: This section would amend sections 212 and 213 of title 18 of the United States Code (18 U.S.C. §§ 212, 213). Current law provides that criminal penalties may be imposed on a Federal bank examiner who examines a bank from which the examiner receives an extension of credit, including a credit card issued by that institution. The financial institution that extends such credit to the examiner also is subject to criminal penalties. The amendment would provide that the Federal financial institutions regulatory agencies, including the Federal banking agencies, may grant exemptions from the prohibition in the law to their examiners by regulation or on a case-by-case basis if an extension of credit would not likely affect the integrity of the examination. The agencies must consult with each other in developing regulations providing for the exemptions and case-by-case exemptions only may be granted after considering certain specific factors. In addition, the amendment expressly provides that examiners may obtain any credit card without disqualification or recusal, but subject to the safeguard that the cards must be issued under the same terms and conditions as cards issued to the general public.

OCC COMMENTS: The banking agencies worked together to develop this amendment. Current law limits the flexibility of the OCC and the other banking agencies to assign examiners to particular institutions or examination teams, even if the extension of credit is on the bank's customary terms and the examiner's skills or expertise would contribute materially to the examination. This amendment would clarify and update the law to permit the agencies to grant appropriate exemptions to the prohibition on extending credit while continuing to ensure that the integrity of our examiners is not compromised.

Sec. 614. Parity in Standards for Institution-Affiliated Parties.

SUMMARY: This section would amend section 3(u)(4) of the FDIA (12 U.S.C. § 1813(u)(4)) to remove the "knowing and reckless" requirement to hold independent contractors to a standard that is more like the standard that applies to other IAPs. Under current law, independent contractor IAPs are treated more leniently under the enforcement provisions in the banking laws than are directors, officers, employees, controlling shareholders, or even agents for the institution or shareholders, consultants, and joint venture partners who participate in the affairs of the institution. To establish that an independent contractor, such as an accountant, has the type of relationship with the insured depository institution that would allow a Federal banking agency to take action against the accountant as an IAP for a violation of law, breach of fiduciary duty, or an unsafe or unsound banking practice, the banking agency must show that the accountant "knowingly and recklessly" participated in such a violation. This amendment would strike the "knowing and reckless" requirement.

OCC Comments: The Federal banking agencies jointly recommend this amendment. The knowing and reckless standard in the current law is so high that it is extremely difficult for the banking agencies to take enforcement actions against accountants and other contractors who engage in wrongful conduct. The amendment will strengthen the agencies' enforcement tools with respect to accountants and other independent contractors.

House Subcommittee on Financial Institutions and Consumer Credit
Hearing on Regulatory Burden Relief
Questions for the Record—Office of Thrift Supervision
March 27, 2003

Questions from Cong. Ruben E. Hinojosa:

Question 1: I am not certain whether or not you are familiar with matricula consulars. This card helps many of the unbanked become banked. It also helps them avoid using check-cashing services to cash payroll checks and expensive wire services to send money to relatives in Mexico. The card also helps reduce crime since Hispanic nationals without the card tend to carry large sums of cash.

Twenty percent to thirty percent of my constituents are unbanked. Matricula consulars are important to helping move some of my constituents away from these expensive wire services and into the traditional U.S. financial services sector. I believe these cards satisfy the personal identification requirements of Section 326 of the Patriot Act currently under review by the Treasury Department. For these reasons, I have introduced legislation, H.R. 773, which would allow Mexican nationals to use Matricula Consulars. My legislation has been endorsed by the Texas Credit Union League, the Independent Bankers Association of Texas, Bank of America, the National Council of LaRaza, and several others.

I pose this question to all of you at the table, do you have a position on the use of these cards? Would my legislation not help relieve financial institutions of certain burdens, such as the confusion created by Section 326 of the Patriot Act? What role does your agency play, or would it play, in supervising a financial institution that accepted matricula consulars?

Answer: The Treasury Department, jointly with the federal banking agencies and other regulators, has issued regulations under section 326 of the Patriot Act governing the requirements for customer identification programs. Under these regulations, financial institutions have discretion to accept a Matricula Consular as a government issued identification card for purposes of verifying the identity of a person seeking to open an account. A number of institutions already accept Matricula Consulars; thus, this is an accepted practice and has not been affected by section 326. With respect to our supervisory role, OTS is responsible for determining whether thrifts establish and execute customer identification programs in accordance with these regulatory requirements.

Question 2: Do all of you think that H.R. 1375 truly creates a level playing field for all the financial institutions in the United States? If yes, how? If not, how would you amend the bill to create a level playing field?

Answer: In its current form, we believe H.R. 1375 would help reduce unnecessary burden on insured depository institutions without compromising safety and soundness or consumer protection. Relief from superfluous regulatory burden enhances the safety and soundness of institutions by avoiding the distraction of complying with needless red tape. Reducing regulatory burden and enhancing supervision are both important in assuring the continued health of our financial services system.

It is important to continue to identify and eliminate unnecessary regulatory obstacles that hinder profitability, innovation, and competition in our financial services industry. This legislation makes an important contribution towards this goal.

We especially appreciate inclusion of amendments to create a level playing field between thrifts and banks under the federal securities laws. The bill eliminates the statutory investment adviser and broker-dealer registration requirements that apply to thrifts but not banks under the Investment Advisers Act of 1940 and the Securities Exchange Act of 1934, respectively. Thrifts offering trust services to their customers incur significant annual costs related to registration with the Securities and Exchange Commission (SEC) under the Investment Advisers Act. Eliminating costs associated with federal securities registration requirements would free up significant resources for thrifts in local communities. This is purely a regulatory cost burden imposed on thrifts, which otherwise enjoy the same powers—subject to the same fiduciary obligations and consumer protection requirements—as banks to conduct investment adviser and broker-dealer activities.

Question 3: Will H.R. 1375 provide enough regulatory relief to financial institutions to enable them to provide funds for economic growth for areas of the country such as mine that desperately need it?

Answer: H.R. 1375 includes a provision that OTS expects to be particularly helpful to thrifts seeking to make community development investments. Section 202 would give thrifts the same authority as national banks and state member banks to make investments to promote the public welfare. This proposal enhances the ability of thrifts to contribute to the growth and stability of their communities. This change will eliminate confusion that can arise when thrifts seek to invest in community development projects and/or companies engaging in community development programs.

The following answers to questions posed by Congressman Hinojosa are provided by the Federal Deposit Insurance Corporation's Division of Supervision and Consumer Protection and the Division of Information Resources

Q. *I am not certain whether or not you are familiar with Matricula Consulars. This card helps many of the unbanked become banked. It also helps them avoid using check-cashing services to cash payroll checks and expensive wire services to send money to relatives in Mexico. The card also helps reduce crime since Hispanic nationals without the card tend to carry large sums of cash.*

20% to 30% of my constituents are unbanked. Matricula Consulars are important to helping move some of my constituents away from these expensive wire services and into the traditional U.S. financial services sector. I believe these cards satisfy the personal identification requirements of Section 326 of the PATRIOT Act currently under review by the Treasury Department. For these reasons, I have introduced legislation H.R. 773, which would allow Mexican nationals to use Matricula Consulars. My legislation has been endorsed by the Texas Credit Union League, the Independent Bankers Association of Texas, Bank of America, the National Council of La Raza, and several others.

I pose this question to all of you at the table, do you have a position on the use of these cards? Would my legislation not help relieve financial institutions of certain burdens, such as the confusion created by Section 326 of the PATRIOT Act? What role does your agency play, or would it play, in supervising a financial institution that accepted Matricula Consulars?

A. Yes, the FDIC is familiar with the Mexican Matricula Consular Card. This is an identification card issued by the local 45 Mexican Consulates in the United States. As you noted, the card can assist many people outside the financial mainstream as a form of identification to join the U.S. banking system. Related to the use of the Matricula Consular Card, FDIC staff has worked with banks in Chicago and Kansas City and the Mexican consulate office to facilitate financial education and banking relationships. FDIC staff is working aggressively across the country with banks and community organizations to bring the "un-banked" into the U.S. banking mainstream via *Money Smart*, our financial education initiative.

On July 23, 2002, the Treasury Department published proposed regulations to Section 326 of the PATRIOT Act, which sets forth the minimum acceptable identification required to open a new bank account. The proposed regulations state that financial institutions must collect the following data from their customers: name, address, date of birth, and an identification number. The identification number for non U.S. persons is further described as: "a taxpayer identification number; passport number and country of issuance; alien identification card number; or *number and country of issuance of any other government-issued document evidencing nationality or residence and bearing a photograph or similar safeguard."*

In its October 21, 2002, Report to Congress on Section 326 of the PATRIOT Act, the Treasury Department stated the following: "...Thus, the proposed regulations do not discourage bank acceptance of the Matricula identity card that is being issued by the Mexican government to

immigrants." Final regulations from the Treasury Department, and other banking agencies, including the FDIC, are pending.

FDIC's position on the use of Matricula by financial institutions is consistent with the Treasury Department's policy. Essentially, as with any other available identifying documents, accepting the Matricula card is a decision for banks to make. Moreover, the FDIC's position has been that, regardless of the identification card, it is incumbent upon the bank to establish procedures relative to what forms of identification are acceptable and to articulate the terms and conditions under which those forms of identification will be honored.

Q. *Do all of you think that H.R. 1375 truly creates a level playing field for all the financial institutions in the United States? If yes how? If not, how would you amend the bill to create a level playing field?*

A. We believe that H.R. 1375 will be very helpful in giving banks and thrifts with different charters similar powers. For instance, Title I, section 105 eliminates the state by state capital requirements on national banks that wish to establish an interstate branch. Section 110 allows national banks to organize as a limited liability company with the associated tax advantages. Under Title II savings associations are given parity to banks under the Securities and Exchange Act of 1934 and the Investment Advisory Act of 1940 in Section 210. Sections 202 gives Federal savings associations authority parallel to that of national banks and State member banks to make investments primarily designed to promote the public welfare, directly or indirectly, by investing in an entity primarily engaged in making public welfare investments. Section 203 gives Federal savings associations parallel authority to merge with one or more of the non-thrift subsidiaries or affiliates. Section 208 adds auto loans and leases for personal, family or household purposes to the list of loans or investments a Federal savings association can make, sell, or deal in without limitations. Section 209 preempts State or local law that requires an agent of a Federal savings association engaged in selling or offering deposit products issued by the savings association to qualify or register as a broker, dealer, or associated person. Other technical changes would also allow insured institutions to compete equally.

Q. *Will H.R. 1375 provide enough regulatory relief to financial institutions to enable them to provide funds for economic growth for areas of the country such as mine that desperately need it?*

A. Some of the changes in H.R. 1375 would help financial institutions to more easily accommodate their business needs and allow for a more efficient use of the institution's resources. Most of the improvement would be incremental, yielding cost savings over time, but would have a limited effect in the short run. Although banks have performed very well through the recent downturn, there are a number of factors affecting bank finances. For many banks the continuing decline in interest rates charged on loan products has begun to affect net interest margins, putting pressure on earnings. Some banks have had increased levels of non-performing loans as a result of the recession. While new delinquencies seem to be declining, the charging off of the old non-performing loans can still force a bank to retrench, particularly if there is

declining earnings. The current uncertain economic environment may make some bankers cautious. The recovery has been slow, and its path is uncertain making lending decisions more difficult. In short, there are many helpful changes in the proposed bill but the financial and economic factors mentioned above will have more direct effects on bank lending than changes in laws or regulation.

Q. *Recently I, along with several of my Democratic colleagues, sent a letter to the FDIC inquiring about the draft examiner guidelines for payday lending. I received a response from you on March 26, 2003 noting that you would consider all comments before issuing a final guidance on payday lending standards. When do you intend to issue these guidelines? Will they be as stringent as your other agency counterparts?*

A. The FDIC received an overwhelming number of comment letters – more than 1,000 – on the draft guidelines for payday lending. The comments, which were submitted by consumer coalitions, payday lenders, law firms, lawmakers, individuals and trade groups, express disparate viewpoints and a wide range of concerns. Given the number of comments and the array of concerns noted, the FDIC must carefully consider and balance all views before issuing final guidelines. We expect to issue final guidelines in the very near term.

Answers Submitted by NASCUS to the Questions Raised by the Honorable Ruben Hinojosa
Hearing on H.R. 1375
Subcommittee on Financial Institutions
March 27, 2003

Question 1
Please provide your views on Matricula Consulars and H.R.773 which would allow Mexican nationals to use Matricula Consulars.

Answer

NASCUS does not have a policy position on the use of Matricula Consular identification cards issued by the Mexican government as a valid form of identification to comply with federal and State statutes and regulations. Official recognition of the Matricula Consular to satisfy the personal identification requirements of The Patriot Act is, in our view, a federal immigration and national security issue beyond our field of expertise. However, some States, local governments and private sector firms do recognize these documents as a valid form of personal identification for a variety of purposes.

We strongly support the many efforts that state chartered credit unions have undertaken to provide access to low cost financial services such as check cashing and international money transfers for those who work or reside in the U.S. and are unbanked and citizens of other countries. If H.R. 773 were enacted, it would help clarify identification procedures that all depository institutions are required to follow before entering into financial transactions with non-U.S. citizens.

Question 2
Do all of you think that H.R. 1375 truly creates a level playing field for all the financial institutions in the United States?....If not, how would you amend the bill to create a level playing field?

Answer

No, we do not. However, the intent of H.R 1375 was limited to removing some of the unnecessary regulatory burdens that limit the efficiency and effectiveness of depository institutions in carrying out their statutory missions. In our testimony before the Subcommittee NASCUS recommended two key improvements to H.R. 1375 that would remove artificial and antiquated obstacles to credit union growth. Those two provisions were:

- reduce the limitations put into law in 1998 that severely restrict credit union member business lending. Give credit unions the same expansion of business lending authority that this bill provides for federal saving associations. Our testimony addressed this issue in detail.

- remove the statutory obstacle that limits the usefulness of supplemental capital raised by credit unions by permitting credit unions to count supplemental capital as a part of net worth for PCA purposes.

These two changes in H.R.1375 would provide a more level playing field for state chartered (and other) credit unions vis-a-vis their depository institution competitors.

Question 3.

Will H.R. 1375 provide enough regulatory relief to financial institutions to enable them to provide funds for economic growth for areas of the country such as mine that desperately need it?

Answer

The current restrictions in law on credit union member business lending limit severely the role that credit unions could play in creating local jobs and supporting community economic development. There is a real need for additional sources of loans for small businesses, particularly micro businesses that are considered too small to be serviced by community commercial banks. Currently the average size of a credit union member business loan is approximately $120,000. Many commercial banks are not structured to make these micro business loans. Many credit unions are.

Congress should amend the Federal Credit Union Act to provide credit unions with the same business lending relief that H.R. 1375 provides for the savings institution business. Credit unions have not objected to expanded business lending authority for savings institutions contained in H.R 1375. We believe that expanded business lending authority for both types of institutions would help create jobs and generate economic development in many local communities.

Additionally, the use of supplemental capital, as stated above, would allow credit unions to have additional capital to support credit union services that would enhance economic growth and job creation.

Governor Mark W. Olson subsequently submitted the following in response to written questions received from Congressman Rubén Hinojosa in connection with the March 27, 2003, hearing before the House Financial Services Subcommittee on Financial Institutions and Consumer Credit:

1. I am not certain whether or not you are familiar with the matricula consulars. This card helps many of the unbanked become banked. It also helps them avoid using check-cashing services to cash payroll checks and expensive wire services to relatives in Mexico. The card also helps reduce crime since Hispanic nationals without the card tend to carry large sums of cash.

20% to 30% of my constituents are unbanked. Matricula consulars are important to helping move some of my constituents away from these expensive wire services and into the traditional U.S. financial services sector. I believe these cards satisfy the personal identification requirements of Section 326 of the Patriot Act currently under review by the Treasury Department. For these reasons, I have introduces legislation, H.R. 773, which would allow Mexican nationals to use Matricula Consulares [sic]. My legislation has been endorsed by the Texas Credit Union League, the Independent Bankers Association of Texas, Bank of America, the National Council of La Raza, and several others.

I pose this question to all of you at the table, do you have a position on the use of these cards? Would my legislation not help relieve financial institutions of certain burdens, such as the confusion created by Section 326 of the Patriot Act? What role does your agency play, or would it play, in supervising a financial institution that accepted matricula consulars?

The Federal Reserve is aware of the use of matricula consulars and the acceptance of these identification cards by many financial institutions, and I would refer you to Chairman Greenspan's response to your previous inquiry on February 28, 2003. As he noted, use of matricula consulars for identification has both potential benefits and risks. In general, the Federal Reserve agrees that promoting access to mainstream financial services by consumers facilitates financial transactions and can increase efficiency in the economy. In this regard, use of matricula consulars can benefit both the consumer and the banking industry. At the same time, acceptance of alternative forms of identification, including matricula consulars, can increase an institution's exposure to fraud.

As a banking supervisor, the Federal Reserve is concerned with the safe and sound operation of depository institutions. Great consideration is given to constructing regulations and policies to maintain a balance between measures to guard against risks and the burden imposed by such requirements. The agencies sought to achieve this balance in

drafting the regulations implementing Section 326 of the Patriot Act, gaining perspective by evaluating approximately 500 comment letters on the proposed regulations, primarily from banks, savings associations, credit unions, and their trade associations. The final rules reflect the elimination of some of the requirements in the proposed regulations that commenters identified as being most burdensome.

In relation to requirements for identifying customers, the final rule provides that a bank must obtain an "identification number" for each customer, using information that permits the bank to establish a reasonable belief that it knows the true identify of the customer. The final rule provides a bank with some flexibility to choose among a variety of identification numbers that it may accept for non-U.S. persons, such as a taxpayer identification number; passport number and country of issuance; alien identification card number; or number and country of issuance of any other government-issued document evidencing nationality or residence and bearing a photograph or similar safeguard. We understand that a matricula consular is issued by the government of Mexico to a citizen that resides in another country and bears a photograph of the individual, and therefore, the number issued on a matricula consular would satisfy this requirement.

The final rule neither endorses nor prohibits bank acceptance of information from particular types of identification documents issued by foreign governments. Regardless of the type of identification information presented by a prospective customer, the burden appropriately remains with the bank to decide for itself, based on relevant risk factors, whether the information presented by a customer is reliable.

The legislation you have introduced may assist financial institutions by clarifying that a matricula consular may be used as a valid form of identification for an individual, as the current rules that implement section 326 allow. Nevertheless, your legislation likely will not affect a financial institution's overall compliance costs because each institution must form a reasonable belief that it knows the true identity of each individual customer regardless of the type of document(s) that may be used by the institution to verify the customer's identity. In other words, even if a financial institution generally accepts the identification number from a matricula consular, the institution must implement a customer identification program that includes risk-based procedures to determine whether the matricula consular may be used for a particular account to verify the customer's identity.

In its supervisory capacity, the Federal Reserve's examination policies and procedures will be applied to monitor compliance with regulations implementing Section 326 to evaluate banks' procedures and risk exposure in the acceptance of any government-issued identification information presented by customers.

2. Do all of you think that H.R. 1375 truly creates a level playing field for all the financial institutions in the United States? If yes, how? If not, how would you amend the bill to create a level playing field?

As I explained in my testimony before the Subcommittee, the Board believes an amendment to section 401 of the bill is necessary to ensure a level competitive playing field for all financial service providers. In particular, while the Board generally supports the provisions of section 401 authorizing insured banks to branch *de novo* across state lines, the Board believes that this new authority should not be granted to industrial loan companies ("ILCs") unless the corporate owners of these institutions are subject to the same supervisory framework as the owners of other insured banks.

ILCs are FDIC-insured banks that may exercise practically all of the same powers as a commercial bank. These institutions, which may be chartered in only a handful of states (Utah, Nevada and California primarily), operate under a special exemption from the Bank Holding Company Act (BHC Act). This special exemption allows companies to own an ILC *without* being subject to the type of consolidated supervision and activities restrictions generally applicable to the corporate owners of insured banks. This special exemption also allows commercial and retail companies to own an FDIC-insured bank despite this nation's historical policy of maintaining the separation of banking and commerce.

As currently drafted, section 401 of the bill would authorize ILCs to branch *de novo* on an interstate basis. This would allow commercial companies that are not supervised or regulated on a consolidated basis to operate a nationwide banking institution. For example, under the bill, large retailers could acquire an ILC and establish a branch in each of their retail stores nationwide. Such a result would place commercial banks, thrifts and their owners at a substantial competitive disadvantage and create an unlevel playing field for financial services in the United States. The Board believes it is important for the owners of ILCs that establish interstate branches to live within the same supervisory regime applicable to all other companies that own insured banks.

3. Will H.R. 1375 provide enough regulatory relief to financial institutions to enable them to provide funds for economic growth for areas of the country such as mine that desperately need it?

H.R. 1375 contains several provisions proposed by the Board that should reduce the regulatory burden imposed on depository institutions. For example, section 401 would remove outdated obstacles on the ability of insured banks to open new branches across state lines, thereby enhancing the ability of insured banks to open branches in under-served areas outside the home state of the bank. Branch entry into new markets improves consumer access to, and choices of, banking services. It also promotes competition in the

local banking market, which benefits consumers through lower interest rates on loans and higher interest rates on deposits.

H.R. 1375 also would eliminate certain reporting requirements imposed on banks and their insiders that do not meaningfully enhance safety and soundness; permit banking organizations to more rapidly consummate bank merger and acquisition transactions that have been approved by the appropriate Federal banking agency and the Department of Justice; and enhance the ability of small depository institutions operating in metropolitan statistical areas to attract and retain qualified directors.

While it is difficult to estimate the financial impact these provisions will have on banking organizations, these provisions should allow depository institutions to operate more efficiently and respond more effectively to the banking needs of consumers and communities.

Responses of Julie L. Williams,
First Senior Deputy Comptroller and Chief Counsel
to Questions of the Honorable Ruben Hinojosa
Concerning the Financial Services Regulatory Relief Act of 2003

Q.1. I am not certain whether or not you are familiar with matricula consulars. This card helps many of the unbanked become banked. It also helps them avoid using check-cashing services to cash payroll checks and expensive wire services to send money to relatives in Mexico. The card also helps reduce crime since Hispanic nationals without the card tend to carry large sums of cash.

20% to 30% of my constituents are unbanked. Matricula consulars are important to helping move some of my constituents away from these expensive wire services and into the traditional U.S. financial services sector. I believe these cards satisfy the personal identification requirements of Section 326 of the Patriot Act currently under review by the Treasury Department. For these reasons, I have introduced legislation, H.R. 773, which would allow Mexican nationals to use matricula consulars. My legislation has been endorsed by the Texas Credit Union League, the Independent Bankers Association of Texas, Bank of America, the National Council of La Raza, and several others.

I pose this question to all of you at the table, do you have a position on the use of these cards? Would my legislation not help relieve financial institutions of certain burdens, such as the confusion created by Section 326 of the Patriot Act?

What role does your agency play, or would it play, in supervising a financial institution that accepted matricula consulars?

A.1. The OCC charters, regulates, and examines approximately 2,100 national banks and 52 federal branches of foreign banks in the U.S., accounting for more than 55 percent of the nation's banking assets. Our mission is to ensure a safe, sound, and competitive national banking system that supports the citizens, communities, and economy of the United States. We currently supervise many financial institutions that accept the matricula consular as a form of identification.

The OCC has consistently urged the banking industry to meet the needs of the unbanked. Most recently, in a speech to the Consumer Bankers Association on April 15 of this year, Comptroller John D. Hawke, Jr., discussed the changing demographics of the United States and explained that the banking industry's future success hinges on its ability to meet the needs of the nation we are in the process of becoming. He discussed the reluctance of some banks to serve minority communities -- which has permitted nonbank competitors to consolidate their foothold in minority markets. He acknowledged that this has presented a significant obstacle for members of minority groups in their bid to achieve economic security and a genuine stake in their communities. He then urged banks to reach out to the new markets that have resulted from the demographic shifts in this country and shared some "best practices" developed by banks that have been successful in ethnic markets.

A bank's ability to meet the needs of its community depends in part on its ability to adequately assess, among other things, the risk that someone is attempting to use the bank to commit a financial crime. The regulation implementing section 326 of the USA PATRIOT Act, recently approved by the OCC and each of the other participating agencies (a copy of which is attached), is designed to help banks in this regard by requiring that they know the true identity of their customers before opening accounts. How a bank satisfies this requirement is, in many respects, left up to the bank, based on its assessment of the relevant risks. These risks will vary between banks and between accounts, depending on the types of accounts maintained by the bank, the methods of opening accounts provided by the bank, the types of identifying information available, and the bank's size, location, and customer base.

The regulation requires each bank to establish a customer identification program that specifies (a) the identifying information that the bank will obtain from someone seeking to open an account and (b) procedures for verifying the information obtained. A person will be required to provide, at a minimum, his or her name, address, date of birth, and a U. S. taxpayer identification number. In lieu of a U. S. taxpayer identification number, a customer who is not a U. S. citizen will be permitted to provide the number and country of issuance of a passport; alien identification card number; or number and country of issuance of any other government-issued document evidencing nationality or residence and bearing a photograph or similar safeguard. A bank may verify a customer's information through documentary methods (*e.g.*, comparing the information against documents provided by the customer) or nondocumentary methods (*e.g.*, checking the information against information available from consumer reporting agencies, public databases, or other sources). If a bank chooses to use documentary methods to verify information, the bank may consider a matricula consular.

Regardless of the verification method used, a bank must have a reasonable belief that it knows the customer's true identity before opening the account. We believe that a bank, in order to achieve this objective, must have the flexibility to evaluate the information provided and reach a decision that it believes is appropriate in a particular situation. For this reason, we are concerned that H.R. 773 may suggest that a customer's identity is irrefutably established by the presentment of a matricula consular. Regardless of the form of document relied on -- whether it is a matricula consular, state-issued driver's license, or some other document -- a bank must conduct an appropriate level of due diligence to ensure to the extent possible that it knows the customer's true identity.

Q.2. Do all of you think that H.R. 1375 truly creates a level playing field for all the financial institutions in the United States? If yes, how? If not, how would you amend the bill to create a level playing field.

A.2. H.R. 1375 takes several significant steps to eliminate unnecessary disparities between national banks and other types of financial services providers. Among the most important are section 110 (which levels the playing field between state and national banks by permitting national banks to organize in any business form – including limited liability companies – in addition to a "body corporate") and section 401 (which would eliminate a distinction drawn in Federal law between banks and Federal thrifts concerning interstate branching).

These are important benefits that will materially reduce needless regulatory burden for national banks. As I noted in my testimony of March 27, however, there are a few ways in which the bill could – and should – be improved. For example, we believe that the bill benefits Federal thrift institutions in certain areas where there is no reason to distinguish Federal thrifts from state or national banks. These provisions include section 213 (Federal court diversity jurisdiction determined only on the basis of where an institution has its main office, eliminating consideration of where it has its principal place of business). Similar issues may exist with respect to some of the other sections. The nature of these provisions is such that, if they are considered appropriate for thrifts, there is no reason not to apply them to banks as well.

In addition, section 107 could be improved to achieve the full benefits of burden reduction and preserve national treatment with national banks. That section provides that the OCC may set the capital equivalency deposit (CED) requirements for a Federal branch or agency as necessary to protect depositors and other investors and to be consistent with safety and soundness. However, that amount cannot be less than the amount required by a state for a state-licensed branch or agency in the state in which the Federal branch or agency is located. We continue to support the included item, as it represents an improvement over the current non-risk-based approach. Under the approach in the current bill, we would consult with appropriate state supervisors to facilitate an appropriate risk-focused implementation of the new standard. However, the OCC suggests that this provision go even further to permit the OCC, after consultation with the Federal Financial Institutions Examination Council, to adopt regulations allowing the CED to be set on a risk-based, institution-by-institution basis. Such an approach would more closely resemble the risk-based capital framework that applies to both national and state banks.

Q.3. Will H.R. 1375 provide enough regulatory relief to financial institutions to enable them to provide funds for economic growth for areas of the country such as mine that desperately need it?

A.3. This legislation, with its focus on burden reduction, should enable insured depository institutions to pursue additional business opportunities and to operate more efficiently. This may result in additional funds being available to meet the needs of the communities served by banks and thrifts. However, the benefits of this Act are perhaps best appreciated in the context of other steps that Congress and the Federal banking agencies have taken encourage investment in the areas that have the greatest need. As you know, the Community Reinvestment Act requires national banks and other insured depository institutions to help meet the credit needs of their entire communities. In addition, national banks have express statutory authority to make investments that are "designed primarily to promote the public welfare."[1] Part 24 of the OCC's regulations implements this authority by allowing national banks to make equity or debt investments that primarily benefit low- and moderate-income (LMI) individuals, LMI areas, or other areas targeted for redevelopment. We have recently proposed to amend Part 24 to minimize the burden and maximize the incentives for insured depository institutions to use this authority creatively.

[1] 12 U.S.C. § 24(Eleventh).

During the past five years, national banks have invested almost $15 million throughout Texas, under Part 24, for activities that help to finance affordable housing and other real estate development and low-cost capital for start-up and expanding small businesses. To highlight a few examples within the 15th District of Texas and surrounding areas, one community bank has used Part 24 to form a community development corporation (CDC) subsidiary and make 8 investments, which total $1,875,470. The CDC used those funds for a variety of activities, such as –

- financing a corporation that owns and operates a charter school, funded by the state, that educates "at-risk" students;
- financing at reduced rates and fees to LMI families that receive tandem subsidies, in two separate programs, from Section 8 Homeownership Program and state subsidies, for the purchase of their first homes;
- investments in an entity that renovated a commercial building, which is leased to the state workforce commission;
- financing a medical student's education, whom upon graduation, has committed to work for a medical facility that provides medical services to low-income families;
- financing the working capital for a small business owner that operates a convenience and hardware store in a LMI community; and
- investment in a fund that provides financing for affordable housing and uses federal low-income housing tax credits.

The Brownsville Community Development Corporation is another example of national banks' Part 24 investments. With current capital of $1.6 million and a $10.5 million loan pool, the multibank CDC provides low-cost capital to developers of community development projects that support low-income residents.

In conjunction with their Part 24 investments, national banks also have taken advantage of the U.S. Department of Treasury CDFI Fund's Bank Enterprise Awards (BEA) Program. BEA grants provide incentives for banks to invest in certified community development financial institutions and to increase their lending and provision of financial services in distressed communities. Within the 15th District and surrounding areas, one national bank received a BEA grant for making a loan to the Brownsville CDC, which was used to construct single family affordable housing in Brownsville. Another national bank received a BEA grant for activities it provided to the Greater McAllen Community Development Corporation. Two national banks each received BEA grants for supporting the McAllen Affordable Homes, an active developer of affordable, single-family housing. Finally, a national bank received a BEA grant to develop and provide special products and financial services that will increase deposits, consumer loans, affordable housing and commercial real estate, and small business and agricultural lending in the economically-distressed areas of Hidalgo County.

Statement Submitted for the Record

of

America's Community Bankers

on

Financial Services Regulatory Relief Act of 2003

before the

Subcommittee on Financial Institutions and Consumer Credit

of the

Committee on Financial Services

of the

U.S. House of Representatives

on

March 27, 2003

America's Community Bankers[1] is pleased to have this opportunity to submit our views on legislation to reduce the regulatory burden on financial institutions. We greatly appreciate the subcommittee's work on the Financial Services Regulatory Relief Act (H.R. 1375), particularly the leadership of the bill's sponsor Representative Shelley Moore Capito, and cosponsors Chairmen Mike Oxley and Spencer Bachus, and Representative Mike Ross.

The legislation includes a number of important community bank priorities as well as many other provisions that will also improve our members' ability to serve their customers. We are particularly pleased that H.R. 1375 retains important provisions added during last year's deliberations to enhance community banks' small business lending and bank service corporation investment authorities. ACB strongly encourages the subcommittee to proceed with the effort and hope that the bill can be further improved as it moves through the process.

Priority Issues

Sec. 401. Branching

ACB strongly supports section 401 which would remove unnecessary restrictions on branching by national and state banks. This will extend to banks many of the benefits of the flexible branching authority now available to savings associations.

Sec. 105. Repeal of intrastate branch capital requirements

We also support section 105 which would eliminate the requirement that a national bank meet the capital requirements imposed by the states on state banks seeking to establish intrastate branches. A national bank's operations are already limited if it is in troubled condition.

Additional Recommendation: Eliminating unnecessary branch applications

A logical counterpart to these proposals to streamline branching and merger procedures would be eliminating unnecessary paperwork for well-capitalized banks seeking to open new branches. National banks, state-chartered banks, and savings associations are each required to apply and await regulatory approval before opening new branches. This process unnecessarily delays institutions' plans to increase competitive options and increase services to consumers, while serving no important public policy goal. In fact, these requirements are an outdated holdover from the times when regulatory agencies spent an inordinate amount of time and effort to determine whether a

[1] America's Community Bankers represents the nation's community banks. ACB members, whose aggregate assets total more than $1 trillion, pursue progressive, entrepreneurial and service-oriented strategies in providing financial services to benefit their customers and communities.

new branch would serve the "convenience and needs" of the community. Now, these decisions are left to the business judgment of the institution itself. ACB's proposal can be found in our appendix, labeled "Eliminating Unnecessary Branch Applications."

Sec. 201. SEC parity

ACB vigorously supports section 201, which would provide parity for savings associations under certain sections of the Investment Advisers Act and the Securities Exchange Act. These provisions will ensure that savings associations and banks are under the same basic regulatory requirements when they are engaged in identical trust, brokerage and other activities that are permitted by law. As more savings associations engage in trust activities, there is no substantive reason to subject them to different requirements. They should be subject to the same regulatory conditions as banks engaged in the same services. The Securities and Exchange Commission has already recognized that it is appropriate to treat banks and savings associations the same under these acts by proposing regulations implementing the Gramm-Leach-Blilely Act exemptions to the broker dealer registration requirements of the Securities Exchange Act of 1934. The SEC has included similar, but incomplete, proposals for exemptions from the Investment Advisers Act in its regulatory agenda.

Section 212. Small business and other commercial loans

ACB strongly supports this provision to grant federal savings associations full small business lending authority and increase the lending limit on other business loans from 10 to 20 percent of assets. ACB appreciates the leadership of Rep. Jim Ryun in crafting this provision during committee consideration.

In 1996, Congress liberalized the commercial lending authority for federally chartered savings associations by adding a 10 percent "bucket" for small business loans to the 10 percent limit on commercial loans. Today, savings associations are increasingly important providers of small business credit in communities throughout the country. As a result, even the "10 plus 10" limit poses a constraint for an increasing number of institutions. The expanded authority provided by this section would enable savings associations to make more loans to small- and medium-sized businesses, thereby enhancing their role as community-based lenders. An increase in commercial lending authority would help increase small business access to credit, particularly in smaller communities where the number of financial institutions is limited. This section does not alter the requirement that 65 percent of an association's assets be maintained in assets required by the qualified thrift lender test.

Additional Recommendations: Real estate lending

ACB urges the subcommittee to add two additional provisions that would further improve savings associations' ability to lend in their communities. One would eliminate an outdated per-unit limit on residential development and the other would increase a limit on commercial real estate loans.

ACB recommends eliminating the $500,000-per-unit limit in the residential housing development provision in the loans-to-one-borrower section of the Home Owners' Loan Act. This limit frustrates the goal of advancing residential development within the statute's overall limit – the lesser of $30 million or 30 percent of capital. This overall limit is sufficient to prevent concentrated lending to one borrower/housing developer. The per-unit limit is an excessive regulatory detail that creates an artificial market restriction in high-cost areas. This ACB proposal can be found in our appendix, labeled "Loans to One Borrower."

ACB also recommends increasing the limit on commercial real estate loans from 400 to 500 percent of capital, and giving the Office of Thrift Supervision the flexibility to increase that limit. Institutions with expertise in non-residential real property lending and which have the ability to operate in a safe and sound manner should be granted increased flexibility. Congress could direct the OTS to establish practical guidelines for non-residential real property lending that exceeds 500 percent of capital. This ACB proposal can be found in our appendix, labeled "Limit on Commercial Real Estate."

Additional Recommendations: Reimbursement for record production

A final ACB priority concerns the cost of producing records for law enforcement purposes. ACB's members have long supported the ability of law enforcement officials to obtain bank records for legitimate law enforcement purposes. The investigation of the September 11 events has highlighted the value of financial records in pursuing terrorists and criminals. In the Right to Financial Privacy Act of 1978, Congress recognized that it is appropriate for the government to reimburse financial institutions for the cost of producing those records. However, that act provided for reimbursement only for producing records of individuals and partnerships of five or fewer individuals. Given the increased demand for corporate records, such as records of organizations that are allegedly fronts for terrorist financing, ACB recommends that the RFPA reimbursement language be broadened to cover corporate and other organization records.

ACB also recommends that Congress clarify that the RFPA reimbursement system applies to records provided under the International Money Laundering Abatement and Anti-Terrorist Financing Act of 2001 (title III of the USA PATRIOT Act). Since financial institutions will be providing additional records under the authority of this new act, it is important to clarify this issue. Both of these proposals can be found in our appendix under "Reimbursement for the Production of Records."

* * * * *

The following highlights ACB's positions on other provisions of H.R. 3951 and proposes additional regulatory relief measures.

Title I – National Bank Provisions

Sec. 101. National bank directors and subchapter S qualification

ACB supports this provision that would allow national banks to use subordinated debt instruments to meet the requirement for directors' qualifying shares. This would ensure that directors retain a personal stake in the financial soundness of the bank, while making it easier for the bank to meet the 75-shareholder limit that defines eligibility for subchapter S tax treatment.

Sec. 102. Voting in shareholder elections

ACB supports this provision to allow national banks to choose cumulative voting to elect directors. This is a matter of corporate governance that can be best determined by each institution.

Sec. 103. Simplifying dividend calculations for national banks

ACB supports this provision to increase the flexibility for national banks in paying dividends deemed appropriate by their boards of directors. Again, this is a matter of business judgment best left to each bank's board of directors.

Sec. 106. Clarification of waiver of publication requirements for bank merger notices

ACB supports the ability of the OCC to waive the publication requirement for in-state mergers in emergency situations or by unanimous vote of the shareholders. This will help avoid unnecessary disruption in these instances.

Sec. 110. Business organizational flexibility for national banks

ACB supports this provision giving national banks the ability to choose among different forms of business organizations. If permitted by the Internal Revenue Service, national banks could use this authority to obtain tax treatment as limited liability corporations.

Title II – Savings Association Provisions

Sec. 202. Investments by federal savings associations to promote the public welfare

Federal savings associations cannot now invest directly in community development corporations, and must do so through a service corporation. National banks and state member banks are permitted to make these investments directly. Since many savings associations do not have a service corporation and choose for other business reasons not to establish one, they are not able to invest in CDCs. ACB strongly supports this amendment to extend CDC investment authority to federal savings associations under the same terms as currently apply to national banks.

Sec. 203. Merger and consolidation of federal savings associations with non-depository institution affiliates

ACB supports this provision to give federal savings associations the authority to merge with one or more of their non-depository subsidiaries or affiliates. This is equivalent to recently enacted authority for national banks.

Sec. 204. Repeal of statutory dividend notice requirement for savings association subsidiaries of savings and loan holding companies and alternative recommendation

ACB supports this provision to give the OTS the discretion to waive the requirement that state savings association subsidiaries of savings and loan holding companies notify the OTS prior to paying a dividend. ACB suggests an alternative approach that would simply eliminate the requirement for well-capitalized associations that would remain well capitalized after they pay the dividend. Under this approach, these institutions could conduct routine business without regularly conferring with the OTS. Those institutions that are not well capitalized would be required to pre-notify the OTS of dividend payments. ACB's proposal can be found in our appendix under "Eliminating Dividend Notice Requirements."

Additional Recommendation: Streamlining subsidiary notifications

ACB recommends the committee eliminate an additional unnecessary requirement that a state savings association notify the FDIC before establishing or acquiring a subsidiary or engaging in a new activity through a subsidiary. Under ACB's proposal, a savings association would still be required to notify the OTS, providing sufficient regulatory oversight. ACB's proposal can be found in our appendix under "Streamlining Subsidiary Notifications."

Sec. 205. Modernizing statutory authority for trust ownership of savings associations

ACB supports this provision that conforms the treatment of trusts that own savings associations to the treatment of trusts that own banks.

Sec. 206. Repeal of overlapping rules governing purchased mortgage servicing rights

ACB supports this provision that would eliminate the 90-percent-of-fair-value cap on valuation of purchased mortgage servicing rights. It would permit savings associations to value purchased mortgage servicing rights, for purposes of certain capital and leverage requirements, at more than 90 percent of fair market value – up to 100 percent – if banking agencies jointly find that doing so would not have an adverse effect on the insurance funds or the safety and soundness of insured institutions.

Additional Recommendation: Extending divestiture periods

ACB further recommends that unitary savings and loan holding companies that become multiple savings and loan holding companies be provided 10 years to divest non-conforming activities, rather than the current 2-year period. This would be consistent with the time granted to new financial services holding companies for similar divestiture under the Gramm-Leach-Bliley Act. The longer time gives these companies time to conform to the law without forcing a fire-sale divestiture. ACB's proposal can be found in our appendix under "Extending Divestiture Period."

Sec. 207. Expanded authority for federal savings associations to invest in small business investment companies

ACB supports this provision that restates in the Home Owners' Loan Act recently enacted statutory authority for federal savings associations to invest in small business investment companies (SBICs) and entities established to invest solely in SBICs. This technical provision will make is easier for savings associations to accurately determine their authority to invest in SBICs by consulting HOLA. Under the new provision, savings associations are subject to an aggregate 5 percent of capital limit on such investments.

Sec. 211. Application of the qualified thrift lender test to an association's multi-state operations as a whole

ACB supports this section that eliminates state-by-state application of the QTL test. This better reflects the business operations of savings associations operating in more that one state.

Sec. 213. Clarifying citizenship of federal savings associations for federal court jurisdiction.

ACB supports this provision that would give federal savings associations parity with national banks in determining corporate citizenship for federal court diversity jurisdiction. Under this provision, a federal savings association will be a citizen of the state where it has its home office.

Title III – Credit Union Provisions

Sec. 301. Privately insured credit unions authorized to become members of a Federal Home Loan Bank

ACB is concerned about this provision that would permit privately insured credit unions to become members of a Federal Home Loan Bank. Every other depository institution that is a member of a FHLBank must be and is federally insured and federally regulated. This helps ensure that these institutions are operated in a safe and sound manner, providing a substantial layer of security for the FHLBank System. The Gramm-Leach-Bliley Act struck a careful balance for the System by equalizing membership requirements for all federally insured depository institutions and reforming the System's

capital system to reflect these changes. Permitting privately insured credit unions that undergo no federal regulatory scrutiny to borrow from the FHLBank System undermines the carefully balanced decisions made in GLB.

Sec. 304. Increase of general 12-year limitation of term of federal credit union loans to 15 years

ACB does not believe it is appropriate to increase from 12 to 15 years the maturity limit for loans made by federal credit unions. This is yet another attempt by tax-exempt credit unions to become more like banks without accepting the responsibilities to pay tax and reinvest in communities.

Sec. 307. Cashing checks for non-members

While this section has a worthy goal, increasing the availability of check cashing services, it would set an unfortunate precedent of allowing credit unions to offer services to non-members. It will also be difficult for credit unions to verify that an individual seeking to cash a check is eligible to become a member. Cashing a check is typically a much more rapid procedure than opening an account, providing inadequate time to accurately determine eligibility. This is apparently part of the credit unions' strategy to expand services beyond members without accepting community reinvestment and taxpayer responsibilities.

Sec. 308. Voluntary mergers and conversions involving multiple common bond credit unions without numerical limitation

This section directly undermines a key provision of the Credit Union Membership Access Act of 1999, which determined the field-of-membership rules for credit unions. In ACB's view, CUMAA was more than generous to the credit unions, especially in light of the fact that they are tax exempt and are not subject to the Community Reinvestment Act. Therefore, we recommend the committee drop this provision to permit voluntary mergers and conversions involving multiple common-bond credit unions without numerical membership limitations. Permitting the merger of large credit unions without numerical membership limitations promotes the creation of massive tax-exempt conglomerates, and harms both community banks and small, locally focused credit unions that generally adhere to the original scope and mission of the industry.

Title IV – Depository Institution Provisions

Sec. 403. Reporting requirements relating to insider lending

ACB supports the provision that would eliminate unnecessary reporting requirements. In addition, we would like to make the following substantive recommendation to change one limitation:

Additional Recommendation: Loans to executive officers

In addition to the language in section 403, ACB recommends that the bill eliminate the special regulatory $100,000 lending limit on loans to executive officers. The limit applies only to executive officers for "other purpose" loans, i.e., those other than housing, education, and certain secured loans. This would conform the law to the current requirement for all other officers, i.e., directors and principal shareholders, who are simply subject to the loans-to-one-borrower limit. ACB believes that this limit is sufficient to maintain safety and soundness. ACB's proposal can be found in our appendix under "Loans to Executive Officers."

Sec. 404. Inflation adjustment for small depository institution under the Depository Institution Management Interlocks Act

ACB supports this amendment to increase the exemption from the DIMIA to $100 million. This will make it easier for smaller institutions to recruit high quality directors. The original $20 million level was set a number of years ago and is overdue for an adjustment.

Additional Recommendation: Interstate acquisitions by savings and loan holding companies

ACB recommends an amendment be added to Title IV to permit a multiple savings and loan holding companies to acquire associations in other states under the same rules that apply to bank holding companies under the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994. This would eliminate restrictions in current law that prohibit (with certain exceptions) a savings and loan holding company from acquiring a savings association if that would cause the holding company to become a multiple savings and loan holding company controlling savings associations in more than one state. ACB's proposal can be found in our appendix under "Interstate Acquisitions."

Sec. 406. Savings association investments in bank service companies

ACB supports this update to allow savings associations to invest in bank service companies. National and state banks may establish these entities to provide services to depository institutions, such as check sorting/posting and bookkeeping. ACB appreciates the efforts of Rep. Melissa Hart to have this provision included in the bill during last year's deliberations.

This amendment is a logical counterpart to the provision in section 503. In some cases, savings associations would prefer to invest in bank service companies, rather than establishing savings association-only companies. By the same token, bank service companies would benefit by being able to attract additional investors.

Title V – Depository Institution Affiliates Provisions

Sec. 503. Eliminating geographic limits on thrift service companies

ACB supports this section that eliminates the single-state geographic limits on savings association service companies. This limit is out of date and ripe for repeal.

Title VI – Banking Agency Provisions

Sec. 601. Waiver of examination schedule to allocate examiner resources

ACB supports this provision to permit the federal banking agencies to adjust examination schedules when necessary to maintain safety and soundness. This provision is likely to benefit well-run community banks.

Sec. 602. Interagency data sharing

ACB supports this extension of data-sharing authority from the Federal Reserve to the other federal banking agencies. We note, however, that this would allow the agencies to share information not only with other supervisory authorities, but with officers, directors, or receivers, or other institution-affiliated entities. In view of the breadth of this provision, ACB recommends that the committee direct the agencies to use this new authority only when needed to advance their mission and to protect against undue infringement on personal privacy.

Sec. 607. Streamlining depository institution merger application requirements

ACB supports this provision to eliminate the requirement that each federal banking agency request a competitive factors report from the other three banking agencies as well as from the Attorney General. This would eliminate the need for redundant reviews.

Sec. 609. Shortening minimum antitrust review period with agreement of the Attorney General

ACB supports this provision to shorten to 5 days the 15-day waiting period when the appropriate federal banking agency and the attorney general agree that a merger or acquisition would not result in a significant adverse effect on competition.

Sec. 613. Credit cards and loans for bank examiners on same terms as other consumers

ACB supports this provision to permit bank examiners to obtain loans from a bank if the examiner fully discloses the nature and circumstances and the examiner's employer determines that the loan will not affect the integrity of the examination. Examiners may also obtain credit cards from banks they may examine, so long as the cards carry the same terms and conditions available to the general public. This will allow examiners, who must have credit cards for travel expenses, to obtain them in the same way as any other consumer.

Sec. 616. Compensation of Federal Home Loan Bank directors

ACB supports eliminating the unnecessary cap on director compensation. This helps maintain the ability of the Banks to adequately compensate directors and take account of the differing needs of individual Bank situations.

Additional Recommendations

In addition to the other recommendations indicated, ACB recommends that the committee include the following provisions in its legislation:

Reducing Debt-Collection Burdens

Under the Fair Debt Collection Practices Act, a debtor has 30 days in which to dispute a debt. This amendment makes clear that a debt collector need not stop collection efforts for that 30-day period while the debtor decides whether or not to dispute the debt. This removes an ambiguity that has come up in some instances. If a collector has to cease action for 30 days, valuable assets which may be sufficient to satisfy the debt may vanish. ACB's proposal can be found in our appendix under "Reducing Debt-Collection Burdens."

Decriminalizing RESPA

This proposal would strike the imprisonment sanction for violations of RESPA. It is highly unusual for consumer protection statutes of this type to carry the possibility of imprisonment. The possibility of a $10,000 fine remains in the law, maintaining adequate deterrence. ACB's proposal can be found in our appendix under "Decriminalizing RESPA."

Conclusion

ACB appreciates this opportunity to present our view on the regulatory relief bill now before the committee. It contains a number of valuable provisions, such as the increased flexibility for bank branching; parity for savings associations under the Securities Exchange Act and the Investment Advisers Act; and increased small business lending authority for savings associations. Our testimony includes several additional suggestions, including the following:

- Eliminating unnecessary branch applications;
- Increasing flexibility in residential real estate and commercial real estate projects; and
- Providing reimbursement for producing records under the Right to Financial Privacy Act and the USA PATRIOT Act.

Appendix

to

America's Community Bankers'

Statement for the Record

on

Regulatory Relief

Thursday, March 27, 2003

Contents

Eliminating Unnecessary Branch Applications

SEC. 1. BRANCH NOTIFICATION BY NATIONAL BANKS— Section 5155(i) of the Revised Statutes (12 U.S.C. 36(i)) is amended to read as follows:

> "(i) A national bank that is well-capitalized (as that term is defined in section 38 of the Federal Deposit Insurance Act) may establish a branch, provided that it notifies the Comptroller within 30 calendar days."

SEC. 2. BRANCH NOTIFICATION BY STATE MEMBER BANKS—Section 22 of the Federal Reserve Act is amended by adding the following new subsection:

> "(i) A State member insured bank that is well-capitalized (as that term is defined in section 38 of the Federal Deposit Insurance Act) may establish a branch, provided that it notifies the Board within 30 calendar days."

SEC. 3. BRANCH NOTIFICATION BY STATE NONMEMBER BANKS—Section 18(d)(1) of the Federal Deposit Insurance Act (12 U.S.C. 1828(d)(1)) is amended to read as follows:

> "(1) A State nonmember insured bank that is well-capitalized (as that term is defined in section 38 of this Act) may establish a branch, provided that it notifies the Corporation within 30 calendar days."

SEC. 4. BRANCH NOTIFICATION BY FEDERAL SAVINGS ASSOCIATIONS– Section 4(m)(1) of the Home Owners' Loan Act (12 U.S.C. 1464(m)(1)) is amended to read as follows:

> "(1) IN GENERAL. A Federal savings association that is well-capitalized (as that term is defined in section 38 of the Federal Deposit Insurance Act) may establish a branch, provided that it notifies the Director within 30 calendar days."

Explanation

Section 1 replaces a requirement that a national bank receive prior approval to open a branch with a provision that permits a national bank to establish a branch so long as it notifies the Comptroller within 30 calendar days.

Section 2 provides that a state member bank may open a branch so long as it notifies the Federal Reserve within 30 calendar days. This overrides the regulatory requirement of Regulation H (12 C.F.R. 208.6).

Section 3 replaces a requirement that a state nonmember bank receive prior approval to open a branch with a provision that permits a state nonmember bank to establish a branch so long as it notifies the FDIC within 30 calendar days.

Section 4 replaces a requirement that savings associations located in the District of Columbia obtain prior approval with a provision that permits any Federal savings association to establish a branch so long as it notifies the Director of OTS within 30 calendar days.

Under current regulatory practice, applications for new branches are routinely granted for strong institutions. Many other application requirements have been replaced with notification procedures. These amendments will expedite the ability of those institutions to open new branches, allowing them to more quickly offer services to additional communities, enhance competition.

Loans to One Borrower

SEC. ___. LOANS TO ONE BORROWER—Section 5(u)(2)(A) of the Home Owners' Loan Act (12 U.S.C. 1464(u)(2)(A)) is amended by striking subclause (ii)(I).

Explanation

In addition to the loans-to-one borrower authority, savings associations may lend the lesser of $30 million or 30 percent of capital for a residential development. Within that overall limit, there is a $500,000 per-unit limit. This amendment eliminates a $500,000 per unit cap, while retaining the $30 million/30 percent limit. The per-unit cap is an excessive regulatory detail that creates an artificial market limit in high cost areas.

Limit on Commercial Real Estate

SEC. ___. COMMERCIAL REAL ESTATE LOANS—Section 5(c)(2)(B)(i) of the Home Owners' Loan Act (12 U.S.C. 1464(c)(2)(B)(i)) is amended by striking "400 percent of the Federal savings association's capital" and inserting "500 percent of the Federal savings association's capital (or such higher amount that the Director determines)".

Explanation

This section increases the limit on commercial real estate loans from 400 to 500 percent and permits the OTS to increase that amount. Institutions with expertise in non-residential real property lending and which have the ability to operate in a safe and sound manner should be granted increased flexibility.

Reimbursement for the Production of Records

SEC. ___. CORPORATE RECORDS—Section 1101(4) of the Right to Financial Privacy Act (12 U.S.C. 3401(4)) is amended by adding ", except that such term shall mean any legal entity for purposes of section 1115 of this Act" after "individuals".

SEC. ___. CLARIFICATION OF SCOPE—Section 1115 of the Right to Financial Privacy Act is amended by adding the following new sentence—

> "This section shall apply to records required to be assembled or provided under the International Money Laundering Abatement and Anti-Terrorist Financing Act of 2001."

Explanation

The Right to Financial Privacy Act provides that the government will reimburse banks for the cost of assembling and providing records of individual bank customers that the government is investigating. This amendment extends that to records of corporate bank customers. The amendment also clarifies that RFPA reimbursement requirements apply to records provided under the International Money Laundering Abatement and Anti-Terrorist Financing Act of 2001.

Eliminating Dividend Notice Requirements

SEC. ___. DIVIDEND NOTICES-- Section 10(f) of the Home Owners' Loan Act (12 U.S.C. 1467a(f)) is amended by adding the following paragraph and redesignating section 10(f) as section 10(f)(1):

> "(2) this subsection shall not apply to a subsidiary savings association that is well capitalized (as that term is defined in section 38 of the Federal Deposit Insurance Act) and will remain well capitalized after the payment of the dividend."

Explanation

Under this amendment, well-capitalized savings associations will no longer be required to notify the OTS of their intention to pay a dividend, provided that they will remain well capitalized after they pay the dividend. This will allow well-capitalized institutions to conduct routine business without regularly conferring with the OTS.

Streamlining Subsidiary Notifications

SEC. ___. STREAMLINING SUBSIDIARY NOTIFICATIONS—Section 18(m)(1)(A) of the Federal Deposit Insurance Act (12 U.S.C. 1828(m)(1)(A)) is amended by striking "the Corporation and" and by striking "each such agency" and inserting "the Director of the Office of Thrift Supervision".

Explanation

This amendment eliminates the requirement that a savings association notify the FDIC before establishing or acquiring a subsidiary or engaging in a new activity through a subsidiary. A savings association will still be required to notify the OTS, providing sufficient regulatory oversight.

Extending Divestiture Period

SEC. ___. EXTENDING DIVESTITURE PERIOD—Section 10(c)(1)(C) of the Home Owners' Loan Act (12 U.S.C. 1467a(c) (1)(C)) is amended by striking "2-year period" and inserting "10-year period".

Explanation

This section provides unitary savings association holding companies that become multiple savings association holding companies have 10 years to divest non-conforming activities. This is the same period granted to new financial services holding companies under the Gramm-Leach-Bliley Act.

Loans to Executive Officers

SEC. 1. LOANS TO EXECUTIVE OFFICERS -- Section 22(g)(4) of the Federal Reserve Act (12 U.S.C. 375a(4)) is amended by striking "in an amount prescribed in regulation of the member bank's appropriate Federal banking agency" and inserting "up to the Member bank's limit on loans to one borrower".

SEC. 2. REPORTING REQUIREMENTS RELATING TO LOANS TO EXECUTIVE OFFICERS.

(a) REPORTING REQUIREMENTS REGARDING LOANS TO EXECUTIVE OFFICERS OF MEMBER BANKS- Section 22(g) of the Federal Reserve Act (12 U.S.C. 375a) is amended--

(1) by striking paragraphs (6) and (9); and
(2) by redesignating paragraphs (7), (8), and (10) as paragraphs (6), (7), and (8), respectively.

(b) REPORTING REQUIREMENTS REGARDING LOANS FROM CORRESPONDENT BANKS TO EXECUTIVE OFFICERS AND SHAREHOLDERS OF INSURED BANKS- Section 106(b)(2) of the Bank Holding Company Act Amendments of 1970 (12 U.S.C. 1972(2)) is amended--

(1) by striking subparagraph (G); and
(2) by redesignating subparagraphs (H) and (I) as subparagraphs (G) and (H), respectively.

Explanation

Section 1 would eliminate the special regulatory $100,000 lending limit on loans to executive officers. The limit applies only to executive officers for "other purpose" loans, i.e., those other than housing, education, and certain secured loans. This conforms the law to the current requirement for all other officers, i.e., directors and principal shareholders, who are simply subject to the loans-to-one-borrower limit.

Section 2 eliminates certain reporting requirements currently imposed on banks and their executive officers and principal shareholders related to lending by banks to insiders. The change in reporting requirements would not alter restrictions on the ability of banks to make insider loans or limit the ability of federal banking agencies to take enforcement action against a bank or its insiders for violation of lending limits.

Interstate Acquisitions

SEC. ___. INTERSTATE ACQUISITIONS-- Section 10(e)(3)of the Home Owners' Loan Act (12 U.S.C. 1467a(e)(3)) is amended by adding the following new subparagraph and redesignating the following subparagraphs accordingly:

"(A) such acquisition would be permissible for a bank holding company under section 3(d) of the Bank Holding Company Act of 1956;"

Explanation

This amendment permits a multiple savings and loan holding company to acquire associations in other states under the same rules that apply to bank holding companies under the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994.

Reducing Debt-Collection Burdens

SEC. ___. CONTINUING COLLECTION EFFORTS – Section 809 of The Fair Debt Collection Practices Act (12 U.S.C. 1692g) is amended by adding the following new subsection and redesignating the following subsection accordingly:

> "(c) Continuing Collection Efforts. A debt collector may continue to collect the debt until the debt collector receives the notice described in subsection (b) of this section."

Explanation

A debtor has 30 days in which to dispute a debt. This amendment makes clear that a debt collector need not wait for that 30-day period while the debtor decides whether or not to dispute the debt.

Decriminalizing RESPA

SEC. ___. ELIMINATION OF IMPRISONMENT SANCTION – Section 8(d)(1) of the Real Estate Settlement Procedures Act of 1974 (12 U.S.C. 2607(d)(1)) is amended by striking “or imprisoned for not more than one year, or both”.

Explanation

This strikes the imprisonment sanction for violations of RESPA. The possibility of a $10,000 fine remains, maintaining adequate deterrence.

Executive Summary

The National Association of Federal Credit Unions (NAFCU) is the only national organization exclusively representing the interests of the nation's federally chartered credit unions. NAFCU is comprised of approximately 900 federal credit unions -- representing approximately 24 million individual credit union members. NAFCU member credit unions collectively account for over 60 percent of the assets of all federal credit unions. NAFCU and the entire credit union community appreciate this opportunity to participate in the discussion regarding regulatory reform and other important issues affecting our nation's credit unions.

Historically, credit unions have served a unique function in the delivery of financial services to Americans. Established by an act of Congress in 1934, the federal credit union system was recognized as a way to promote thrift and to make financial services available to people, many of whom otherwise would have no access to credit. Congress established credit unions as an alternative to banks and to fill a precise public need—a niche that credit unions fill today for over 82 million Americans. While more than 65 years have passed since the *Federal Credit Union Act* (FCUA) was signed into law, two fundamental principles regarding the operation of credit unions remain every bit as important today as in 1934:

- Credit unions remain totally committed to providing their members with efficient, low cost personal service; and,
- Credit unions continue to emphasize traditional cooperative values such as democracy and volunteerism.

Unlike banks, membership in a credit union is not open to the general public; a credit union may serve only those individuals within its field of membership. Federal credit unions have an independent federal regulator (the National Credit Union Administration - NCUA) and an insurance fund (the National Credit Union Share Insurance Fund - NCUSIF) separate from the bank and thrift insurance funds managed by the Federal Deposit Insurance Corporation (FDIC).

As the package of financial services offered by various financial institutions becomes ever more homogenized, the emphasis has begun to shift from types of service to quality and cost of service. Credit unions are second to none in providing their members with quality personal service at the lowest possible cost. According to the 2002 *American Banker*/Gallup Consumer Survey, credit unions had the highest rated service quality of surveyed financial institutions. In fact, credit unions have received higher marks in every *American Banker*/Gallup Consumer Survey since 1989 -- a trend that shows no sign of change.

As in the case with banks and thrifts, there has been substantial consolidation within the credit union community in recent years. The number of credit unions has declined significantly – by more than 50% - over the course of the past 30 years, from an all time high of 23,866 in 1969 to 10,039 at year-end 2002. Similarly, the number of federal

credit unions has declined as well, declining by just about 50% over that same period, from a high of 12,977 in 1970 to 5,953 at year-end 2002.

This decline has been consistent, with each year since the mid-1970's seeing a net decline in the number of credit unions. The experience of federal credit unions in this regard tracks that of all credit unions. Looking solely at federal credit unions, the two most significant factors contributing to the decline in the number of federal credit unions is merger activity and conversion from federal to state charter.

NAFCU believes that the *Financial Services Regulatory Relief Act of 2003*, H.R. 1375, is a very positive step in addressing some of the regulatory burdens and restrictions on federal credit unions resulting in a number of federally chartered credit unions to consider converting to state charters. NAFCU applauds the balanced approach evidenced in the bill and commends Representatives Capito and Ross for their leadership in introducing this important legislation. NAFCU supports all the provisions included in Title III of the legislation.

NAFCU believes the bill is a balanced approach in its current form and we understand the sponsor's desire to include only a manageable number of provisions in the legislation, we would like to call the Subcommittee's attention to some additional issues that fall into the scope of the legislation:

- Remove "local" from the definition of "community" for purposes of community charters
- Relax the "Reasonable Proximity" requirement
- Relax the current member business loan restriction imposed by CUMAA
- Secondary Capital
- Eliminate the preference imposed by CUMAA for the formation of new credit unions over the addition of groups to an existing credit union.

NAFCU believes that the state of the credit union community is strong and the safety and soundness of credit unions is unquestionable. Nevertheless, we urge the Subcommittee to carefully assess the trend of conversions from federal to state charters. We believe that H.R. 1375 is an excellent first step. We understand that it is a work in progress by the Subcommittee and we urge the Subcommittee to undertake a careful examination of what other measures fall within the scope of this legislation that will address the concerns we have articulated. We look forward to working with you on this important piece of legislation and would welcome your comments or questions.

NAFCU

Testimony on Behalf of
The National Association of Federal Credit Unions

Subcommittee on Financial Institutions and Consumer Credit
United States House of Representatives

"Financial Services Regulatory Relief Act of 2003"
H.R. 1375

March 27, 2003

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Written Testimony On behalf of the
National Association of Federal Credit Unions
Before the Subcommittee on Financial Institutions and Consumer Credit
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March 27, 2003

Table of Contents

Introduction

The National Association of Federal Credit Unions (NAFCU) is the only national organization exclusively representing the interests of the nation's federally chartered credit unions. NAFCU is comprised of approximately 900 federal credit unions -- financial institutions from across the nation -- representing approximately 24 million individual credit union members. NAFCU–member credit unions collectively account for over 60 percent of the assets of all federal credit unions. NAFCU and the entire credit union community appreciate this opportunity to participate in the discussion regarding regulatory reform and other important issues affecting our nation's credit unions.

Historically, credit unions have served a unique function in the delivery of financial services to Americans. Established by an act of Congress in 1934, the federal credit union system was recognized as a way to promote thrift and to make financial services available to people, many of whom otherwise would have no access to credit. Congress established credit unions as an alternative to banks and to fill a precise public need—a niche that credit unions fill today for over 82 million Americans. Every credit union is a cooperative institution organized "for the purpose of promoting thrift among its members and creating a source of credit for provident or productive purposes." (12 USC 1752(1)). While more than 65 years have passed since the *Federal Credit Union Act* (FCUA) was signed into law, two fundamental principles regarding the operation of credit unions remain every bit as important today as in 1934:

- Credit unions remain totally committed to providing their members with efficient, low cost personal service; and,
- Credit unions continue to emphasize traditional cooperative values such as democracy and volunteerism.

Credit unions are not banks. The nation's approximately 10,000 federally insured credit unions serve a different purpose and have a fundamentally different structure, existing solely for the purpose of providing financial services to their members. As owners of cooperative financial institutions united by a common bond, all credit union members have an equal say in the operation of their credit union —"one member, one vote" — regardless of the dollar amount members have on account. These singular rights extend all the way from making basic operating decisions to electing the board of directors. Unlike their counterparts at banks and thrifts, federal credit union directors, motivated solely by a desire to be of service to others, serve without remuneration — a fact epitomizing the true "volunteer spirit" permeating the credit union community.

Also, unlike banks, membership in a credit union is not open to the general public; a credit union may serve only those individuals within its field of membership. Federal credit unions have an independent federal regulator (the National Credit Union Administration - NCUA) and an insurance fund (the National Credit Union Share Insurance Fund - NCUSIF) separate from the bank and thrift insurance funds managed by the Federal Deposit Insurance Corporation (FDIC).

Unlike thrifts, credit unions have never cost the American taxpayer a dime. Unlike the FDIC and the Federal Savings and Loans Insurance Corporation (FSLIC) – the precursors to Bank Insurance Fund (BIF) and the Savings Association Insurance Fund (SAIF) – that were started with seed money that came as taxpayers' dollars from the United States Treasury, every dollar that has ever gone into the NCUSIF has come from the credit unions it insures. And unlike the thrift insurance fund, credit unions have never needed a federal bailout.

America's credit unions have remained true to their mission of "promoting thrift" and providing "a source of credit for provident or productive purposes." In fact, Congress acknowledged this point when it adopted the *Credit Union Membership Access Act* (CUMAA – P.L. 105-219). In the "findings" section of that law, Congress declared that, "The American credit union movement began as a cooperative effort to serve the productive and provident credit needs of individuals of modest means ... [and they] continue to fulfill this public purpose."[1]

Today, credit unions play an important role in the lives of millions of Americans from all walks of life. As the package of financial services offered by various financial institutions becomes ever more homogenized, the emphasis has begun to shift from types of service to quality and cost of service. Credit unions are second to none in providing their members with quality personal service at the lowest possible cost. According to the 2002 *American Banker*/Gallup Consumer Survey, credit unions had the

[1] 12 USC 1752(1).

highest rated service quality of surveyed financial institutions. In fact, credit unions have received higher marks in every *American Banker*/Gallup Consumer Survey since 1989 -- a trend that shows no sign of change.

In addition, credit unions continue to serve those of modest means. Since the passage of CUMAA in 1998, federal credit unions have added over 500 underserved areas, providing an additional 25.4 million individuals the opportunity to obtain much needed low-cost financial services.

CUMAA and Beyond

Credit unions have been under assault by the banking industry for nearly two decades. The Supreme Court's decision in 1998 in the *AT&T Family Federal Credit Union* field of membership case brought the issue to a head. Congress' prompt passage of CUMAA in the summer of 1998 was seen by many as a significant victory for credit unions. When Congress sent that bill to President Clinton to be signed into law it overturned in six short months a decision that had encompassed eight years of litigation.

Make no mistake about it, CUMAA was a necessary piece of legislation for credit unions at the time of its enactment because it codified a number of fundamental credit union concepts embraced by both federal and state-chartered credit unions. These include:

- the multiple-group policy that NCUA had initiated in 1984;
- the "once a member always a member" principle followed by virtually every credit union in the country; and,
- the "family member" concept followed by so many credit unions.

Yet CUMAA came with some provisions that were not widely supported by the credit union community. These include:

- limitations on member business loans;
- imposition of a bank-like Prompt Corrective Action or "PCA" requirement that, given the structure of credit unions, serves in many respects as an overly restrictive constraint on growth; and
- various other artificial and arbitrary limitations on growth.

Following the passage of CUMAA, NAFCU recognized that there was still more important work to be accomplished. In January of 2000, the NAFCU Board of Directors, recognizing a growing trend of credit union conversions from federal to state charter singled out the erosion of the federal charter as a critically important issue for NAFCU and the nation. In February of 2000 NAFCU convened a "task force" of federal credit union and former federal credit union CEOs, including those who had converted to federally insured state-chartered credit unions and mutual thrifts. This group met to discuss their concerns related to the federal charter in the post-CUMAA environment.

Below are highlights of some of the comments NAFCU heard at that session and in subsequent meetings:

- If NCUA wants to do anything that will help smaller credit unions they should work to eliminate unnecessary and needless regulations and work with Congress to repeal laws which are only serving to drive small financial institutions out of business.
- The (charter expansion) process has a chilling effect on Select Employee Group (SEG) acquisition efforts.
- Mergers seem to be a viable and necessary method to create a substantial number of financially strong credit union entities that can compete with each other as well as with banks and other financial institutions. The business about greater or less than 3000 potential members is a serious obstacle.... The solution may well be in additional legislation.
- It is important that the regulatory environments allow for ...continued growth and not impair our ability to remain competitive.

As a result of these meetings, it became clear that both regulatory and legislative action was needed in the post-CUMAA environment.

The Current Situation

NAFCU is pleased to report to the Subcommittee that America's credit unions are vibrant and healthy and that membership in credit unions continues to grow with credit unions serving over 82 million Americans--more than at any time in history. At the same

time, it is important to note that while credit union membership continues to grow, over the past 21 years credit unions have increased their market share only minimally and as a consequence provide little competitive threat to other financial institutions. According to data obtained from the Federal Reserve Board, during the 21 year period from 1980 to 2001 the percentage of total household financial assets held by credit unions increased from 1.4% to 1.7% or merely 0.3% over the course of 21 years.

As is the case with the banks and thrifts, there has been substantial consolidation within the credit union community in recent years. The number of credit unions has declined significantly – by more than 50% - over the course of the past 30 years, from an all time high of 23,866 in 1969 to 10,039 at year-end 2002. Similarly, the number of federal credit unions has declined as well, declining by just about 50% over that same period, from a high of 12,977 in 1970 to 5,953 at year-end 2002.

This decline has been consistent, with each year since the mid-1970's seeing a net decline in the number of credit unions. The experience of federal credit unions in this regard tracks that of all credit unions.

Looking solely at federal credit unions, the single most significant factor contributing to the decline in the number of federal credit unions is merger activity. Between 1999 and 2002 more than 70% of the decline in the number of federal credit unions was due to mergers. (In fact, 78.6% of the decline in federal credit union charters outstanding was due to mergers in 1999, 76.7% in 2000, 80.2% in 2001, and

77.8% in mid-year 2002). The effect of mergers on the federally chartered credit union system in terms of assets has, however, been significantly smaller totaling just $1.0 billion in 2002.

The second most significant factor contributing to the decline in the number of federal credit unions over the 1999 to 2002 time period was, however, conversions from federal to state charter: 11.5% in 1999, 12.5% in 2000, 6.3% in 2001, and 6.84% in mid-year 2002. This translates into 40 in 1998, 34 in 1999, 32 in 2000, 21 in 2001, and 21 in 2002. The aggregate five-year total is $28.3 billion in assets, representing 9.44% of the total assets of the 2002 federally chartered credit union system.

While these numbers might suggest that the conversion trend has peaked, this is hardly the case. According to NCUA there are 7 federal-to-state conversions reportedly pending. In addition, the size of credit unions converting from federal to state charter, and therefore the total assets involved in such conversions, is on the increase; the average assets and median assets are dramatically increasing.

It is perfectly normal, if not expected, for conversions to occur in a healthy dual chartering system, but it is an entirely different matter when the trend is significantly skewed, as it has been over the past five years in the conversion from federal to state charter. We have found after talking to credit unions that the root cause of the current trend is the more rigid field of membership policies and/or their application at the federal level rather than at the state levels. In this regard, NAFCU conducted a predictive

analysis of federal credit union conversions based on field of membership, state, asset size, membership penetration rate, prior merger activity, county population and the poverty rate. The analysis, which was based on prior conversions, indicated that:

- Growth-oriented multiple common bond federal credit unions with a relatively large asset size and low current field of membership penetration rate in a state with a more liberal field of membership have a greater probability to seek state charter conversion.

- Federal credit unions in suburban versus rural areas with a relatively low percentage of low-income households are likely to convert as a result of community charter restrictions.

As a result of this analysis and the actions that NAFCU has taken to gather member input, the other reasons for conversions that NAFCU has identified include:

- The desire for regulatory flexibility that is deemed requisite to survive and to grow in the 21st century.
- The need to diversify membership and portfolios.
- The elimination of unnecessary and needless regulations.
- The need to innovate and enable credit unions to meet their future membership needs.
- The ability to offer investment and insurance products that meet membership needs.

- The offering of a more favorable business climate.
- The need for a progressive and pro-business regulatory environment.
- Active solicitation by state regulators to encourage federally chartered credit unions to convert to state charter.

Another trend that emerged in NAFCU's analysis is that when both a state-charted credit union and a federally chartered credit union merge, the resulting credit union more often than not opts to retain a state charter. To provide the committee with additional background as to why credit unions may be converting to state-chartered credit unions, NAFCU has prepared a comparison of federal and state laws and regulations of those states that have seen the most conversions over the last five years (Appendix A).

NAFCU Meets with Policymakers to Enhance the Federal Charter

Deficiencies in federal chartering policies and/or their application by NCUA cannot be remedied without bringing these matters to the attention of key policy makers in Washington.

Over the past three years, NAFCU has been working with NCUA Board Chairman Dennis Dollar and other NCUA Board members in an attempt to improve the regulatory environment. We are pleased to see that these efforts have been fruitful in several respects:

- A single-sponsor credit union may now retain that status while continuing to serve a spun-off division of the sponsor that was in the federal credit union's field of membership prior to the enactment of the CUMAA.

- A single-sponsor federal credit union may now retain that classification while bringing in groups in which the sponsor has a 10% ownership interest.

- When a group within a credit union's field of membership undergoes a corporate restructuring or reorganization, the credit union may now also serve any new members of that group without having to go through the SEG addition process.

- Currently, NCUA has proposed additional changes to its *Chartering and Field of Membership Manual* which may go into effect as early as April 2003.

On the legislative front NAFCU has spent the past two years meeting with legislators to compile a package of initiatives that would serve to restore the balance between the federal and state chartering systems. NAFCU has suggested a series of recommendations designed to enhance the federal charter, several of which are contained either in whole or in part within the *Financial Services Regulatory Relief Act of 2003*. Today's credit unions exist in a very dynamic environment, and we realize that the laws and regulations dealing with credit union issues will always be in need of further review and refinement. NAFCU's goal in crafting its recommendations was to ensure the continued viability of the federal charter for credit unions. NAFCU continues

to refine its guiding principles on enhancing the federal charter (See Appendix B: *Enhancing the Federal Charter – Moving Credit Unions into the 21st Century.*)

Financial Services Regulatory Relief Act of 2003

NAFCU believes that the *Financial Services Regulatory Relief Act of 2003*, H.R. 1375, is a positive step in addressing some of the regulatory burdens and restrictions on federal credit unions that have caused a number of federally chartered credit unions to consider converting to state charters.

NAFCU applauds the balanced approach evidenced in the bill and commends Representatives Capito and Ross for their leadership in introducing this important legislation. We would like to offer the following observations, comments, and feedback on what we believe are positive aspects of the legislation *(listed in order of section number)*.

A. Section 301. NAFCU believes that all credit unions should carry federal insurance. However, NAFCU recognizes that the authorization for private insurance – either by law or regulation - continues to exist in several states. As long as private insurance is authorized, NAFCU supports allowing privately insured credit unions to become members of the Federal Home Loan Bank system.

B. ***Section 302.*** NAFCU supports this effort to give credit unions land leases on federal property under the same terms and conditions as credit unions now are provided space allotments under the FCUA. The credit unions that will be impacted by this change are defense (military) credit unions that have tried to expand their service to our men and women in uniform by building (and paying for) their own member service centers on military facilities. Many that have expanded their services by building their own facilities to serve military personnel have had their leases go from a nominal fee (e.g. $1.00 a year) to a "fair market value" rate of over $2000 a month. For non-profit cooperatives like credit unions, this change in leasing costs will inevitably lead to higher fees and/or fewer services for the men and women on that base.

C. ***Section 303.*** NAFCU supports this effort to increase investment options for federal credit unions by allowing certain investments in securities. The current limitations in the FCUA unduly restrict federal credit unions in today's dynamic financial marketplace and have the potential to adversely impact both safety and soundness in the future. We believe that federal credit unions should have the same investment authority that is approved for other federally regulated financial institutions with regulation by the NCUA Board.

D. ***Section 304.*** NAFCU supports this provision that would increase the general 12-year limitation of term of federal credit union loans to 15 years or

longer as permitted by the NCUA Board. The current 12-year limitation is outdated and does not meet with maturities that are commonly accepted in the market today. We believe that it is important that the NCUA Board have the rulemaking authority to extend this limitation beyond 15 years in order to address the flexibilities that are necessary in today's market.

E. ***Section 305.*** NAFCU supports this provision to increase the one percent investment limit in credit union service organizations (CUSOs). However, we believe that the bill should go further than just raising the limit to three percent and, rather, give the NCUA Board the authority to set the proper investment limit.

F. ***Section 306.*** NAFCU supports this effort to exclude loans or loan participations by federal credit unions to non-profit religious organizations from the member business loan limit.

G. ***Section 307.*** NAFCU supports efforts to increase credit union services by allowing federal credit unions to offer check-cashing and money transfer services to anyone in their field of membership. By Congress' granting this additional authority, we believe that credit unions can play an important role in fighting abuses by some current providers of remittances to many of our nation's immigrants.

H. ***Section 308.*** NAFCU supports this clarifying provision that the numerical limitation of 3,000 to consider spinning off and forming a separate credit union should not apply to voluntary mergers of healthy credit unions. In addition, we believe that the retroactive effective date of August 7, 1998 (the date of enactment of CUMAA), is an important part of this section and must be maintained.

I. ***Section 309*** NAFCU supports efforts that give NCUA the authority to allow credit unions to continue to serve their select employee groups (SEG's) after a credit union converts to a community charter. Current law does not allow this, penalizing not only the credit union, but also those in its field of membership.

J. ***Section 310*** The FCUA contains many antiquated "governance" provisions that, while appropriate in 1934, are today outdated, unnecessary and inappropriate restrictions on the day-to-day operations and policies of a federal credit union. NAFCU supports this effort to give credit union boards greater flexibility in the management of their credit union. In addition, we would strongly recommend that similar "governance" provisions be removed from tne FCUA and left to the determination of individual credit union Board of Directors subject to rules and regulations promulgated by the NCUA Board.

K. ***Section 311*** NAFCU supports the idea of giving NCUA greater latitude in adjusting interest rates depending on market conditions. Under current law

federal credit unions are the only type of insured institutions subject to federal usury limits on consumer loans.

L. ***Section 312*** NAFCU supports the inclusion of this language which would exempt credit unions, just as banks and thrifts are already exempt, from the pre-merger notification requirements of the Hart-Scott-Rodino Act.

M. ***Section 313*** The Gramm-Leach-Bliley Act provided banks with registration relief from certain specifically enumerated activities, and section 201 of the Financial Services Regulatory Relief Act of 2003 provides similar relief to thrifts. NAFCU supports providing credit unions regulatory relief along those same lines from the requirement that they register with the Securities and Exchange Commission as broker/dealers when engaging in certain activities.

NAFCU believes the bill is a balanced approach in its current form and we understand the sponsor's desire to include only a manageable number of provisions in the legislation, Nevertheless, we would like to take this opportunity to call the Subcommittee's attention to some additional issues that NAFCU believes can and should be included in H.R. 1375.

A. Remove "local" from the definition of "community" for purposes of community charters. Today's dynamic financial marketplace characterized by "cyber-banking" technology rather than bricks and mortar makes the word

"local" an extraneous limitation for community-chartered credit unions. In addition, and as previously noted, this provision has accounted for the majority of conversions from federal to state charters. We believe this word should be removed and the NCUA Board should be given the regulatory flexibility to set the definition as it deems fit.

B. Relax the "Reasonable Proximity" Requirement This requirement is an undue burden on credit unions, requiring them to have a physical presence within a reasonable proximity of the location of a group that the credit union wants to add to its field of membership. In the financial marketplace of the 21st century that has seen an increase in Internet and remote banking, this requirement serves as an unnecessary burden and restriction on credit unions and those who wish to join them.

C. Relax the current member business loan restriction imposed by CUMAA. This cap was imposed as part of CUMAA in 1998 and limits a credit union's member business lending to the lesser of either 1.75 times net worth or 12.25 percent of total assets (12 USC Section 1757a(a), 1790d). A CUMAA mandated Treasury Department study (*Credit Union Member Business Lending: January 2001*) found that "credit unions' business lending currently has no effect on the viability and profitability of other insured depository institutions" and was often filling a market niche for business loans of modest amounts. If an outright removal of the cap is not plausible, we would recommend that there should at

least be parity with the 20 percent cap on thrifts that is included in section 212 of the *Financial Services Regulatory Relief Act of 2003*, H.R. 1375.

D. Secondary Capital NAFCU is concerned about the challenge some credit unions face in raising adequate capital in a PCA (prompt correction action) environment. First and foremost, credit unions today remain safe and sound. At the same time, the flight to safety that has occurred over the past two years – and is continuing to occur – as a result of external economic environmental factors totally outside of the control of credit unions has resulted in unprecedented growth that is extremely difficult, if not impossible, to curtail. What the future holds is very difficult, if not impossible, to predict.

Recognizing the potential challenges that might be encountered in the future, and to ascertain sources that might provide credit unions additional capital, the NAFCU Board convened a task force to study this vexing issue. In so doing, the NAFCU Board set forth the following criteria for the development of a workable solution to secondary capital:

- preserving the not-for-profit, mutual, member-owned and cooperative structure of credit unions (ensuring that ownership interest remains with the members, to include influence);

- ensuring that the capital structure of credit unions is not fundamentally changed and that the safety and soundness of the credit union community as a whole is preserved;
- providing a degree of permanence such that a run on capital will not occur,
- providing a workable means to augment capital;
- providing a solution with market viability;
- ensuring that any proposed solution applies for PCA purposes (to include risk-based capital as appropriate);
- providing a solution which flows through the income statement for PCA purposes (or changing the definition of net worth to include other capital types while also ensuring that ownership interest remains with the members, to include influence); and,
- ensuring that any proposed solution qualifies as capital under generally accepted accounting principles (GAAP).

This issue remains under study and review. In keeping with the above criteria for the development of a workable solution to secondary capital, NAFCU has, however, in the interim endorsed a modification to the statutory definition of

"net worth" to mean "equity capital," rather than the "retained earnings balance" of the credit union as determined under GAAP. Currently, credit union mergers are accounted for by using the "pooling method," meaning that the net worth of each merging credit union is combined to form the net worth of the surviving credit union: $5M (net worth of credit union A) + $5M (net worth of credit union B) = $10M (net worth of credit union AB). However, the Financial Accounting Standards Board has proposed to eliminate pooling and impose the purchase method of accounting. Using this method and the current definition of net worth (which is "retained earnings") as required by PCA, the net worth of the surviving credit union is only $5M (retained earnings of credit union A) + $5M (retained earnings of credit union B) = $5M (net worth of credit union AB). Therefore, under the purchase method of accounting, only the surviving credit union's retained earnings count as net worth for PCA purposes. As a result, the surviving credit union may have trouble meeting PCA requirements, unless credit union net worth is redefined to mean equity capital.

E. Eliminate the preference imposed by CUMAA, for the formation of new credit unions over the addition of groups to an existing credit union. Oftentimes, an existing credit union is better suited to meet the needs of a SEG and offer it better services than a new credit union would or could. Most SEG applicants do not have the time, money, or critical mass to form their own credit union. According to NCUA, since the passage of CUMAA in 1998 there have not been any SEG groups whose applications have been denied that have gone on

to form their own credit union. These individuals have, therefore, been left without credit union services.

Finally, NCUA Chairman Dennis Dollar has recently suggested that a risk-weighted asset system would be appropriate to provide less risky credit unions credit unions additional regulatory relief. NAFCU believes that a risk-weighted approach has significant merit and is in keeping with the criteria that NAFCU has adopted for the development of a workable solution to secondary capital. Accordingly, we look forward to working with Chairman Dollar to carefully study and consider the merits of a risk-based approach and to work to develop a risk-based proposal for Congressional consideration.

Conclusion

NAFCU believes that the state of the credit union community is strong and the safety and soundness of credit unions is unquestionable. Nevertheless, we urge the Subcommittee to carefully assess the trend of conversions from federal to state charters. We believe that H.R. 1375 is an excellent first step. We understand that it is a work in progress by the Subcommittee and we urge the Subcommittee to undertake a careful examination of what other measures fall within the scope of this legislation that will address the concerns we have articulated. We look forward to working with you on this important piece of legislation and would welcome your comments or questions.

Appendix A

Federal/State Law Comparison

STATE	FEDERAL/STATE LAW COMPARISON
California	• California law does not list all of the possible categories for field of membership. In federal law, categories are expressed as single common-bond credit union, multiple common-bond credit union, or community credit union. • Groups within the field of membership must comply with the principles of organizing a credit union including common bonds of occupation, association, or groups within a well-defined neighborhood, community, or rural district. **California regulator has interpreted law very broadly to permit statewide fields of membership.** • FCUs are subject to personal property taxes. State chartered credit unions are exempt from personal property taxes. • Wild Card provision: a credit union may engage in any activity available to it if it were an FCU. • Secondary capital allowed. Except with the approval of the commissioner, the total number of shares issued by the credit union to nonmembers cannot exceed 20 percent of the unimpaired capital and surplus of the credit union. • Under state law, no board member is compensated. With an FCU, one member may be compensated and board determines who it will be.
Texas	• Under Texas law, members of a credit union must share a common interest in accordance with its articles of incorporation or bylaws, including one based on occupation, association or residence. Texas law allows credit unions more flexibility in determining who can become a member. **While members may include those outlined in federal law, state law does not require definite categories of those who may qualify for membership.** • Immediate family member is not defined. • Wild card provision: a credit union may engage in any activity in which it could engage, exercise any power it could exercise, or make any loan or investment it could make, if it were operating as a federal credit union. • Texas law allows secondary capital. • Federal law allows that only one member of the board may be compensated, while state law does not provide that option. However, state law does allow for some employee benefits. While persons serving as director, honorary director, advisory director or committee member of a CU may not receive compensation, they may be provided health, life, accident insurance or similar protection and reimbursed for any expenses incurred in performing his duties.
Florida	• Florida law requires a limited field of membership similar to the express categories of field of membership under the federal law. **As such, the difference between state and federal laws rests on interpretation as Florida permits broad state fields of membership, which has resulted in conversions of some credit unions to state charter.** • Board members may hold office for such terms as the bylaws provide. NCUA bylaws provide for board terms of either two or three years. • Wild card provision: Subject to the prior approval of the department, state financial institutions subject to the financial institutions codes may exercise any power which they could exercise if operating as a federally chartered financial institution. • Florida law allows secondary capital. • Members of the board may be reimbursed from the assets of the corporation for reasonable and necessary expenses incurred by them as members of the board of directors, but no members of the board shall be compensated for their services.
Idaho	• Idaho law is broader with respect to groups that may be allowed to join a state credit union. Membership in a credit union consists of the subscribers to the articles of incorporation and such other persons having the common bond set forth in the articles. The articles may vary by credit union. • Idaho permits tax only on real property, while FCUs may be taxed on real and tangible personal property. • Wild card provision: an Idaho chartered credit union, subject to the approval of the Director of the Department of Finance, may exercise powers and authority granted to credit unions by the other states. • Idaho allows secondary capital. • No officer, director, or committee member may be compensated, directly or indirectly, for his services as such; provided, however, an elected member of the board of directors may serve as a part-time treasurer

STATE	FEDERAL/STATE LAW COMPARISON
	and receive a salary for his services.
Connecticut	• Connecticut's membership eligibility rules are similar to federal law. A common bond is based on occupation or association. However, there are exceptions that will allow some groups membership without being in a category as expressed in federal law upon the Commissioner's determination. State law also requires that a multiple common bond membership be limited to fewer than 3000 members at the time the group is first included in membership. However, this provision may be waived with the Commissioner's approval. **Greater state regulator flexibility has prompted federal credit unions to convert to state charter.** • Immediate family member is defined as any person related by blood, adoption, or marriage. • Super wild card provision: effective October 1, 2002, section 36a-250(a)(41) of SB 91, the wild card provision, will be amended to provide that a Connecticut credit union may engage in activities that an out-of-state credit union may be authorized to engage in under state law. • Connecticut credit union officers ,directors and committee members may be reimbursed for reasonable and necessary out-of-pocket expenses actually incurred and paid in the performance of their official duties.
Indiana	• Indiana law makes eligible the same groups eligible for membership under federal law. However, Indiana law also includes a list of all qualified groups. **Federal field of membership limitations have prompted federal credit unions to convert to state charter.** • A qualified group consists of: persons with a common bond of occupation, trade, or professional association; members of a labor organization; members of a church; persons in a common trade or profession within a well defined geographical location; employees of the credit union; persons who are members of a farm bureau cooperative, or other farm bureau organization, and who have subscribed to one (1) or more shares; or persons who reside or are employed within a community. The ability of communities to be added as groups will permit state-chartered credit unions to obtain broad, statewide fields of membership. The department may approve expansion of a credit union's membership with an additional qualified group. • Wild card provision and parity; allows an Indiana chartered credit union, subject to the approval of the Department, to exercise the powers and authority granted credit unions by the other states. A credit union that intends to exercise any rights and privileges that are granted to federal credit unions but not authorized for credit unions under the Indiana Code shall submit a letter to the department requesting such rights for approval. • CUs are subject to state taxes. Taxes paid include real and personal property taxes.
Colorado	• The Colorado definition of a common bond is similar to the federal definition. Common bonds may be based on employment, association, or a well-defined neighborhood, community or rural district. The geographic common bond must have a population of less than 25,000 people. While the geographic common bond definition is stricter than the comparable federal provision, the limit of 25,000 can be waived. **Greater flexibility in expansion rules is causing federal credit unions to convert to state charter.** • Colorado has a more liberal definition of immediate family member than the federal definition. Immediate family means persons related by blood, by marriage, or by adoption. • Colorado credit unions must be audited every 18 months. • Wild card provision: with the approval of the Commissioner, credit unions may engage in any activity that is permitted for a federal credit union. • The treasurer of the credit union may be compensated for his or her service as treasurer. No other member of the Board or other committees may be compensated (added 7/30/02)
Illinois	• The definition of a common bond is similar to the federal language. Common bonds may be based on employment, association, or community. A community bond common bond requires a reasonably well-defined neighborhood or community. **A more flexible interpretation by the state regulator, including the approval of broad, multiple-county fields of membership, is causing many federal credit unions to convert to state charter.** • Illinois law more broadly defines immediate family member. The state definition includes "any relative by blood or marriage or foster and adopted children." • Statutory lien does not require notice to member.

STATE	FEDERAL/STATE LAW COMPARISON
	• No restrictive merger rules. • Credit unions may amend their bylaws with the approval of the Director. They are not required to select from standard bylaws. • Credit unions are audited biennially. • Wild card provision: Credit unions can engage in activities in conformity with the Federal Credit Union Act • Effective July, 2002, credit unions may use secondary capital (added 7/30/02)
Michigan	• Michigan's definition of common bond is similar to the federal definition. A common bond may be based on occupation or association or groups within a well-defined neighborhood, community, or rural district. The common bond required for a community credit union may be more restrictive than that required by federal law. In addition to requiring a well-defined area, Michigan requires a common bond based on relatively close geographical proximity to one another, personal acquaintance among the residents, and the existence of a community of interests, activities, and objectives. • Michigan law requires no standard bylaws. • No set terms for directors. • No maturity limits and the maximum interest rate is higher (25% compared to 18%) for loans. Loan conditions set forth in credit union's bylaws. • Credit unions may invest in investment securities as long as the credit union has a reasonable basis to believe the obligation will be fulfilled. • Only real estate is not tax-exempt. • Wild card provision: the Commissioner may issue rules allowing state credit unions to exercise any of the powers conferred on federally chartered credit unions. • Michigan is considering a major revision to its credit union laws. The Michigan Credit Union Modernization Working Group proposed an overhaul of the Michigan Credit Union Act, including an elimination of the common bond requirement for membership in favor of allowing credit unions to determine their own field of membership with the Commissioner's approval, and an extension of the examination cycle to 18 months.
Ohio	• Any credit union may, with the approval of the Superintendent, amend its articles of incorporation to permit select groups having a common bond of occupation or association or select groups within a well-defined neighborhood, community, or rural district, to become members of the credit union. **Greater flexibility in expansion rules is causing many federal credit unions to convert to state charter.** • Directors may be removed by a vote of the board of directors or by a membership vote. • Incidental powers provision permits credit unions to exercise powers granted to state corporations that are not inconsistent with the state statute. • Wild card provision: the Superintendent can issue rules giving state credit unions the same right, power, privilege, or benefit as FCUs. • Directors may receive per diem wages for their services to the credit union (added 7/30/02)
Washington	• Washington's definition of common bond is similar to the federal definition: common bonds may be based on occupation, association, or a well-defined neighborhood, community, or rural district. **However, liberal interpretation by the state regulator has led to broad state fields of membership.** • No standard bylaws. • No statutory maturity limits on loans for state-chartered credit unions. • Washington credit unions are audited only every 18 months instead of annually. • Wild card provision: A credit union has the powers that a FCU has, and an out-of-state credit union operating a branch in Washington has, if the Director finds that the exercise of the power serves the members of credit unions, and maintains the fairness of competition and parity between credit unions.
Minnesota	• Minnesota recently adopted a new credit union law, which will become effective 8/1/2002. • The new law allows credit unions to add small groups (less than 500 potential members) to their fields of membership without prior approval from the Commissioner. • The law increases the power of credit unions in areas such as selling insurance to members, offering loans, and offering trust-related services. • Wild card provision - the law allows state chartered credit unions to engage in any activity in which federally chartered credit unions are permitted to engage.

STATE	FEDERAL/STATE LAW COMPARISON
	• The law increases the percentage of unimpaired assets that a credit union may borrow from 40% to 50%. • Current Minnesota law incorporates a broader definition of family members. Any blood or adoptive relative of a member may join a credit union. • In adding groups to the field of membership, groups of less than 1,500 are considered too small to start their own credit union. Groups over this size will be considered according to all relevant factors. • Credit unions may invest in any investment legal for savings banks or trust funds in the state. This provision relaxes investment opportunities for state credit unions. • Members of the Board, supervisory committee, or other committees may not receive salaries, but they may be compensated through hourly wages (added 7/30/02)

Appendix B

NAFCU's Guiding Principles

National Association of Federal Credit Unions

NAFCU

NAFCU's Guiding Principles on Enhancing the Federal Charter – Moving Credit Unions into the 21st Century

Preserving credit union uniqueness

NAFCU is a strong proponent of credit union growth and innovation - to ensure that credit unions remain competitive in the financial marketplace of the 21st century. At the same time, the foundations of service, cooperation, self-governance and common purpose that make credit unions unique must be preserved. Federal credit unions are, by definition, institutions that: are organized and operated for mutual purposes without profit; do not issue capital stock; are governed by volunteer boards; and have fields of membership. NAFCU would oppose any initiatives that might significantly alter these fundamental characteristics and thereby jeopardize the nonprofit, unique, and tax exempt status of credit unions.

Field of membership changes

NAFCU believes that all Americans should have access to credit union services within the field of membership concept, which remains a defining characteristic of credit unions. The field of membership concept, however, must be flexible to adapt to a changing society and an evolving financial services marketplace. NAFCU believes that legislative changes in this area should include:

- eliminating the term "local" from the definition of "community"
- eliminating the language in the CUMAA that indicates a preference for starting new credit unions, in lieu of permitting employee groups to join an existing credit union
- allowing community-SEG combinations
- confirming authority for healthy credit unions to merge voluntarily
- easing the ability of FCUs to add low-income groups to their FOMs
- allowing community-based FCUs to serve members in communities merged or spun off into other municipalities - "once a potential member, always a potential member"

NAFCU also believes that the NCUA could make a number of regulatory changes to include:

- the establishment of a new type of common bond based on employment in a trade, industry, or profession
- increasing the threshold for the expedited process for SEG applications to 3,000
- further liberalizing the reasonable proximity requirement to include ATMs as a service facility and credit union partial ownership in a shared facility
- expanding the definition of local community, neighborhood, or rural district
- liberalizing the restrictions on voluntary mergers

Lifting MBL restrictions

NAFCU believes that credit unions have a key role to play in providing needed capital to credit union members who are small business owners, and it has pressed for lifting these restrictions. The 2001 Treasury Department study on MBL indicates that credit union business loans go primarily to small businesses (many of the loans are for $50,000 or less); these loans fill a niche oftentimes not served by commercial lenders.

In addition, the Treasury Department has noted that it does not view these loans as a competitive threat to banks. Finally, NAFCU believes that all federally insured credit unions should be permitted to participate in the lending programs offered by the Small Business Administration.

Retaining volunteer boards

NAFCU believes that volunteer boards - elected by a credit union's members - are a hallmark of the Federal credit union system. Volunteer boards, along with "one member, one vote" elections, are unique aspects of Federal credit unions that demonstrate their cooperative and democratic foundation.

At the same time, NAFCU supports granting discretionary authority to boards to approve reimbursement of additional types of appropriate out-of-pocket expenses incurred by directors in fulfilling their duties.

Secondary capital

"NAFCU is concerned about the challenge some credit unions face in raising adequate capital in a "PCA" ("Prompt Corrective Action") environment. To provide credit unions additional sources of capital, NAFCU believes that workable proposals should be carefully developed that maintain the not-for-profit, mutual ownership, and cooperative structure of credit unions, while ensuring that the capital structure of credit unions is not fundamentally changed and that the safety and soundness of the credit union community as a whole is preserved. Accordingly, NAFCU supports Congressional action to amend the Federal Credit Union Act to authorize NCUA to promulgate rules and regulations regarding secondary capital accounts for all federally insured credit unions."

Maintaining NCUA's independence

NAFCU believes it is imperative that credit unions have an independent regulator, one that recognizes the unique characteristics of credit unions and serves as an advocate for the preservation of credit unions' unique status under the law. Accordingly, NAFCU strongly supports the continued independence of NCUA and would oppose any proposals to fold NCUA into a larger federal agency as that would dilute the direct impact credit unions have on the formulation of NCUA policy. NAFCU also supports the current NCUA Board structure.

Keeping NCUSIF strong

The National Credit Union Share Insurance Fund (NCUSIF) has an unparalleled record of protecting credit union members' shares. NAFCU does not believe it is necessary at this time to change the way the fund is financed, and it does not support separating NCUSIF from NCUA. While NAFCU does not oppose efforts by credit unions to augment NCUSIF insurance with supplemental private insurance, NAFCU continues to believe that NCUSIF insurance should remain mandatory for all federally chartered credit unions.

The federal charter: still valuable

In conclusion, NAFCU believes the federal charter remains an extremely valuable "franchise" for credit unions. At the same time, NAFCU intends to continue its prudent, measured approach to change - from both a regulatory and legislative perspective - adding value to the charter while preserving the core characteristics that make credit unions the unique financial institutions they are.

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